

Business retail price review 2016: final determinations

About this document

From April 2017, 1.2 million businesses, charities and public sector organisations (“businesses”) that are customers of water companies operating wholly or mainly in England will be able to choose their supplier of water and wastewater retail services. Businesses that are customers of companies operating wholly or mainly in Wales will be able to choose their retailer for water (but not wastewater services) if their premises are supplied with at least 50 mega litres (Ml) of water per year.

Following market opening, eligible businesses are able to change their retailer and select a package of price and services that best meets their needs. And, in England, some business customers may find themselves transferred to another retailer if their provider exits the business retail market and no longer provides retail services for business customers.

Our business retail price controls provide additional protections for customers until competition becomes effective. They do this by providing protection for business customers while enabling the development of competition. Continuing price control protection will also be needed for those customers of companies operating wholly or mainly in Wales, where there will be no competition and customers will not be able to choose their retailer.

This document sets out our final determinations for business retail price controls for the three year period from April 2017. These final determinations take into account the responses that we received to our September [draft determinations](#) and has been developed consistent with the approach we set in our May [statement of method](#). Our final determinations also reflect the differences in the market arrangements that will apply to England and Wales.

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Table on page 55-56 updated on 15 December 2016.

Overview

Introduction

In 2014, the UK Government put in place legislation to enable eligible customers¹ to switch water and wastewater retailer. For customers supplied by companies operating wholly or mainly in England those eligible will include all business customers. For companies operating wholly or mainly in Wales the current 50Ml per year threshold will be retained and the restriction of competition to water supply only will continue, reflecting the policy position of the Welsh Government.

From April 2017, eligible business customers will be able to choose their retailer and select the package of prices and retail services that best suits their needs. The new market will also provide opportunities for:

- innovation to flourish;
- the most efficient retailers to grow; and
- the development of new water management and efficiency services.

Our PR14 price review final determinations set business retail price controls for a five year period, although we indicated that we would review these arrangements prior to market opening. Our business retail price controls set the total allowed revenue that a retailer can earn for a given customer type based on, an allowed average cost per customer and a net margin as well as forecasts of wholesale revenue and customer numbers in each year (see chapter 1). Companies set charges that comply with the annual allowed revenue controls for each customer type which are called default tariffs.

In reviewing the default tariff cap arrangements we recognised that water companies whose areas are wholly or mainly in England can exit the business retail market and no longer provide retail services for business customers. We also recognise that default tariff caps only apply to existing tariff structures and will not apply to new tariffs that retailers may introduce when the market opens.

¹ Information on eligibility is available through our [Eligibility guidance on whether non-household customers in England and Wales are eligible to switch their retailer](#) and [Supplementary guidance on whether non-household customers in England and Wales are eligible to switch their retailer](#).

However, for companies remaining in the business retail market and for those planning to enter it, the arrangements that we are setting will be key to the development of the business retail market. In particular, where an incumbent water company whose areas are wholly or mainly in England intends to exit the business retail market (and no longer provide retail services for business customers), the [Retail Exit Code](#) provides that the licensee taking over responsibility for the business retail customers will need to comply with our business retail price controls unless they have negotiated a specific contract with the business concerned.

In May 2016, following consultation with stakeholders, we issued our [statement of method](#) that set out our approach to this price review (PR16), including how we would assess company proposals for the business retail price controls for the period between 1 April 2017 and 31 March 2019. Our approach was designed to ensure that the price controls will not create undue barriers to competition while providing an appropriate level of backstop protection for customers in the transitional period until competition becomes effective.

In September 2016, following consideration of company proposals, we published our PR16 [draft determinations](#). Stakeholders were asked to respond to these draft determinations by 28 October 2016.

This document sets out our final determinations for the business retail PR16 price controls for the 17 water and sewerage companies (WaSCs) and water-only companies (WOCs) in England and Wales.² These final determinations recognise that the Welsh Government's decision that retail competition in Wales will remain at current levels and the price controls that will apply to these activities reflect the different conditions as regards competition that apply to these customers.

Our approach to PR16

Our statement of method explained our approach to setting the business retail price controls. In summary:

- The business retail price controls should provide back-stop protection for customers and enable the development of competition by offering a comparison

² Since PR14 Bournemouth Water has merged with South West Water so we only need to set 17 price controls as part of PR16.

point for customers when the market opens so they can determine if they would be better off by changing suppliers.

- For the smaller customers (those using less than 5MI of water or wastewater per year), the form of control will remain default tariff caps. These customers may need greater protection as they may be less able, at least initially, to take advantage of the competitive market (as will those customers of companies operating wholly or mainly in Wales not able to participate in the competitive markets) and to provide confidence that the new market arrangements will not unduly disadvantage groups of customers.
- For the largest customers, the form of the control would be simplified through applying uniform caps on the gross margins for water and wastewater customers in the 5MI to 50MI per year consumption range and for those using at least 50MI per year. Importantly, this simplification will still allow companies wholly or mainly in England to set different tariffs for customers that fall into these consumption bands while meeting the overall gross margin cap.
- Companies were provided an opportunity to re-allocate their overall costs and margins across all their default tariff caps. To protect smaller customers there would be a high evidential threshold for increases in the overall level of cost and margin allowances made at PR14. And, where companies proposed rebalancing of costs/margins that result in increased prices for smaller customers, they would need to provide comprehensive and robust supporting evidence.
- Different arrangements would be appropriate for companies operating wholly or mainly in Wales to reflect the different competitive conditions that apply to water supply services to customers using at least 50MI of water per year. Customers who are water and wastewater customers can still switch but only switch their water supply and not their wastewater services.

Our draft determinations

Having considered the evidence submitted by companies to support their PR16 proposals (including from South West Water in relation to its South West and Bournemouth areas) we concluded that the use of simpler backstop price controls to protect larger customers (those best able to take advantage of the competitive market) would be appropriate. We also concluded that for smaller customers in England (those using less than 5MI of water or wastewater per year) business retail default tariff caps remained appropriate. We also considered that default tariff caps remained appropriate for customers using less than 50MI of water per year in Wales.

And, having considered the specific detail of the PR16 proposals put forward by companies we concluded that:

- Bristol Water's, Dee Valley Water's, Portsmouth Water's and South West Water's (in relation to its South West area) proposals were acceptable as their new default tariff caps for customers using less than 5MI of water or wastewater per year involved no or very limited changes to their PR14 caps.
- Affinity Water's, South East Water's, South Staffordshire Water's, Southern Water's, and Sutton and East Surrey Water's proposals were acceptable as their new default tariff caps for customers using less than 5MI of water or wastewater per year involved only minor changes from their PR14 caps and they provided relevant supporting evidence. Yorkshire Water's proposal also appeared to involve minor changes and we indicated that its proposal would be acceptable provided that it provided more information on price impacts and evidence to support its approach.
- Severn Trent Water's, United Utilities' and Wessex Water's³ proposals involved more significant changes to their PR14 caps but were acceptable as they provided comprehensive supporting evidence. South West Water also suggested more significant changes to the PR14 caps applying in its Bournemouth area. We changed its proposal by adjusting its cost base to reflect changes in customer numbers and used this modified proposal as the basis for its draft determination.
- For the purposes of draft determinations, we decided to retain the PR14 price caps for Anglian Water, Dŵr Cymru, Northumbrian Water and Thames Water as their proposals were not supported by evidence that was sufficiently transparent, convincing and/or robust.

Responses to our draft determinations

Twelve companies supported our draft determinations.⁴ Five companies either submitted new evidence in support of their PR16 proposals or revised their PR16

³ In Appendix 2 of the PR16 draft determinations we noted that Wessex Water's PR16 proposal would result in smaller customers experiencing a small increase in bills. That was incorrect. Instead these customers are expected to experience a slight reduction relative to PR14.

⁴ There will be separate controls for the South West and Bournemouth areas, although these two companies merged in 2015.

proposals and submitted new evidence. Two respondents (including the Consumer Council for Water) commented on our overall approach and/or specific aspects of our analysis. Chapter 1 sets out our assessment of the issues raised with respect to our overall approach. Chapter 2 sets out our assessment of the new evidence provided by companies and the revised proposals provided by Anglian Water, Dŵr Cymru, Northumbrian Water and Thames Water. It also outlines our final determinations of all the business retail price controls that will apply from April 2017.

Our final determinations

Having considered the responses to our draft determinations we have concluded that we will:

- not increase the overall allowances for costs and net margins, as the evidence provided by respondents to our draft determinations on these matters did not satisfy the evidential thresholds described in our statement of method and draft determinations. These matters are discussed further in chapter 1.
- retain the proposals for gross margin bands for customers using at least 5Ml of water or wastewater per year (and a supplementary restraint on price increases to these customers) as set out in our draft determinations and explained further in chapter 1.
- set default tariff caps for customers using less than 5Ml of water or wastewater per year on the following basis (and described in more detail in chapter 2):
 - For the 12 companies (including South West Water that has made proposals for separate default tariff caps for its South West and Bournemouth areas) that accepted our draft determinations, we will carry those conclusions forward into their final determinations. This includes our proposed modification of South West Water's proposal for Bournemouth Water.
 - We have considered the additional information that we requested from Yorkshire Water and have found that this evidence is sufficient to allow us to accept its PR16 proposal (used as the basis for its draft determination) for its final determination.
 - We have rejected Northumbrian Water's PR16 proposal at draft determination but having carefully considered the additional clarifications and information it has provided in response to the draft determinations we have decided to accept its PR16 proposal for its final determination.

- Dŵr Cymru and Thames Water submitted revised proposals in response to our draft determinations and additional supporting information and evidence. We have accepted these revised proposals for their final determinations.
- Anglian Water, in its response to our draft determination, submitted further information in support of its PR16 proposal (which we rejected at draft determination) including in relation to its representations that it should receive a higher overall allowances for costs. We have decided that this information does not meet the evidential thresholds described in our statement of method and so we have decided to retain the PR14 caps used in its draft determination in its final determination.

Next steps

Alongside this document we are publishing the notifications of our final determinations for 17 companies. Each notification is the legal instrument setting out our final determination of price controls for business retail activities for each company.

Each company will have two months to decide whether to ask us to refer its determination to the Competition and Markets Authority (CMA). If a company wishes Ofwat to refer its determination to the CMA it must let us know in writing no later than 15 February 2017.

Our PR16 price controls will come into effect from April 2017 and will be in place for three years. They will be considered as part of the PR19 process and will be revised, if required, in time for 2020.

As part of the arrangements for the development of business retail competition, incumbent water companies whose areas are wholly or mainly in England can exit the business retail business and will no longer provide retail services for business retail customers. Instead these customers can be transferred to a separate retailer, which can be an associated retailer (part of the same group) or a separate retailer. Where this occurs, the [Retail Exit Code](#) requires that for transferred customers the retailer will need to continue to comply with our business retail price controls unless these customers have negotiated a specific contract with the retailer concerned. The Retail Exit Code also applies the price controls to any small and medium sized

business⁵ customers in an area where the incumbent water company has exited the market. Larger business customers are protected through non discrimination and no undue preference provisions in the Retail Exit Code. We will review these protections three years after market opening.

Document structure

This document is structured as follows:

- Chapter 1 explains our views on the overall level of cost and margin allowances, and the simplification of the price controls set out in the draft determinations.
- Chapter 2 sets out our final determinations of the default tariff caps for each of the 17 licensees and includes our assessment of the new information provided by licensees in response to the draft determinations. In undertaking this assessment of companies' revised proposals we have drawn heavily on the analysis outlined in chapter 1.

[Appendix 1](#) contains the company tables that have been used in our final notifications for the PR16 controls. [Appendix 2](#) lists company acronyms that we have used for the figures in chapter 1.

⁵ A small and medium sized business has fewer than 250 employees.

1. Overall allowances for costs and margins, and simplification

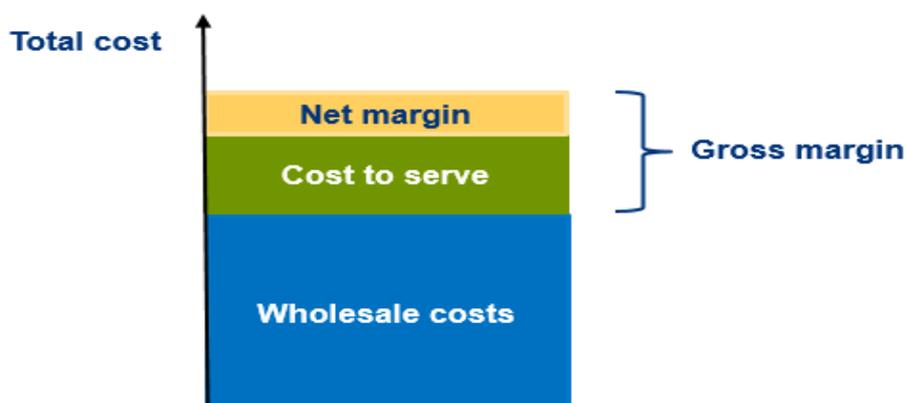
This chapter describes the scope of the PR16 Review and our final decisions on key aspects of our approach to PR16:

- structure of the business retail controls (section 1.1);
- overall allowances for business retail cost to serve (section 1.2);
- overall allowances for business retail net margins (section 1.3);
- form of control and simplification (section 1.4);
- the supplementary restraint (section 1.5);
- eligibility and the Regulatory Accounting Guideline (section 1.6); and
- publication of information (section 1.7).

1.1 Structure of the business retail controls

The PR14 final determinations set an allowed average retail cost per customer type and a net margin. Customer types were proposed by each company. For each customer type, companies were required to set charges, referred to as default tariffs that complied with the annual allowed average retail control. Default tariffs reflect the maximum allowed average revenue per customer type and are the default charges that business customers will pay (although customers will be free to choose other, new and innovative tariffs that are outside our price controls, if available). Default tariffs are calculated by reference to:

- an allowance for business retail costs (costs associated with billing, meter reading and other customer services);
- the charges for wholesale services (necessary to calculate retail margins); and
- an allowed overall retail net margin to provide for the efficient financing and reasonably remunerate risk. The overall retail net margin allowance was set at 2.5%, except for customers of companies operating wholly or mainly in Wales using less than 50MI of water per year (who will not be able to switch their retailer), for whom the overall net margin allowance was set at 1%.

Figure 1.1 Composition of a default tariff

This form of the business retail price control fixes the components of the gross margin (rather than total revenue) for each tariff band and each company's total business revenue will vary with:

- changes to customer numbers so the control should automatically adjust for any loss of customers such as that associated with the development of competitive pressures; and
- changes in wholesale charges as the net margins are fixed as a percentage uplift (to avoid changes in wholesale charges distorting competition).

Within each tariff band, each company will retain the freedom to set tariffs for its customers provided that it meets the overarching requirements of the price control and acts consistently with its other legal obligations (including those relating to competition law).

The PR14 business retail price controls resulted in more than 250 average revenue controls and associated default tariffs across the companies.

The PR14 business retail price controls were set to operate between 1 April 2015 and 31 March 2017. We stated that we would review these arrangements prior to the opening of the English market in April 2017.

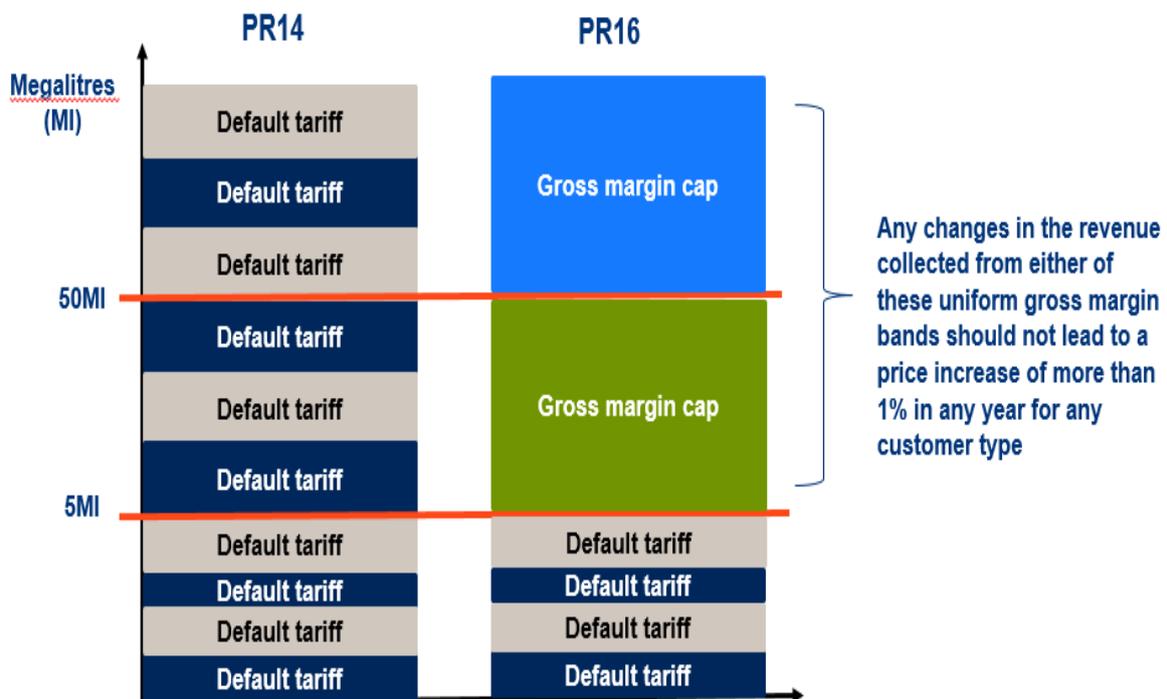
The aim of the resulting PR16 Review is to ensure that business retail price controls do not create barriers to entry to the market or expansion. It is important that customers have the ability to secure deals to meet their needs while having sufficient protection to promote trust and confidence in the water sector until the market operates in a way to deliver this.

The scope of the PR16 review as outlined in our statement of method was to:

- allow companies to review the allocations of business retail costs and margins to default tariff caps ahead of market opening in April 2017;
- simplify the form of control applying to larger customers (those consuming at least 5MI of water per year in England and at least 50MI of water in Wales, which are most likely to be best placed to take advantage of the development of competition) through introducing a national form of price control across all companies based on a uniform cap on the allowed gross retail margin (instead of the default tariff caps set at PR14);
- for smaller customers (those consuming less than 5MI of water per year in England), retain company specific default tariff caps.⁶

Our PR16 approach consequently provided greater flexibility for companies to set tariffs for individual customers as long as they met on average the uniform gross margin caps (for customers consuming at least 5MI of water or wastewater per year) and the company specific default tariffs for consumption below this.

Figure 1.2 Business retail controls – PR14 and PR16



⁶ In Wales, due to the different levels of competition present, company specific tariff caps will be retained for all customers using less than 50MI per year of water.

The PR16 process enabled companies to submit proposals on the:

- overall allowances for business retail cost to serve;
- overall allowances for business retail net margins;
- re-allocation of costs and margins across tariffs; and
- simplification of company specific tariffs into two gross margin bands covering customers in the 5 to 50MI water or wastewater per year and at least 50MI water or wastewater per year consumption ranges.

1.2 Overall allowances for business retail cost to serve

In our statement of method we stated that the available evidence suggested that it was appropriate to retain the overall level of business retail cost allowances set at PR14. However, we noted that should substantial new evidence emerge as part of the PR16 process that demonstrates that the existing cost to serve allowance was not in the best interests of customers, we would take this into account in setting price controls.

At draft determinations we considered but did not accept Anglian Water's and Northumbrian Water's proposals to increase the overall cost to serve allowances. The evidence submitted in support of their proposals did not meet the high evidential threshold that we set out in the statement of method and that it would not be in the interests of customers to increase allowances for costs.

Since publishing our draft determinations we have received further representations on the overall allowances for business retail cost to serve:

- Anglian Water re-iterated its claim for an overall increase in aggregate retail costs (see discussion on Anglian Water later in this section (and chapter 2 for our overall assessment of its revised PR16 proposal)).
- Clear Business Water (a potential new entrant) considered that effective retail market competition would be facilitated by further scrutiny of the retail cost allowance for smaller customers (those consuming less than 5MI of water or wastewater per year) to ensure that all overhead costs (IT systems) and individual costs (bad debts, billing and meter reading) have been accounted for in the overall cost allowance. Clear Business Water indicated that smaller customers may be excluded from the benefits of competition for market opening until the next price review as the margins available and cost to serve of smaller customers means they are perceived as less attractive prospective customers or potentially not even viable for some smaller new entrants with less working

capital. Clear Business Water does not expect customer bills to increase but consider that the cost to serve and wholesale costs should be split fairly across the smaller and larger customers for each company.

Having assessed the material submitted in response to our draft determinations we consider that it would not be in the interests of customers to increase the overall allowance for retail costs at this time. We now explain our reasoning in relation to each company that submitted a case for this.

Anglian Water

Anglian Water made representations in response to our draft determination on the overall level of its costs. It suggested that a 31% increase was needed due to:

- its underlying base level of costs being above PR14 levels;
- extra accommodation costs due to its use of separate buildings;
- extra staff to support separation of its retail and wholesale operations; and
- costs of new IT systems.

It justified these costs in terms of its desire to operate a standalone business capable of delivering competitive retail services and because its forecasts are based on the costs it is currently incurring, thereby according to Anglian Water providing strong justification for the robustness of its forecasts.

The supporting evidence that Anglian Water has provided to us has not been consistent with the high evidential threshold described in our statement of method and draft determination. In particular, there are substantial gaps in the evidence that Anglian Water has provided relative to that which we would expect to see to justify a claim for extra cost allowances. The shortcomings in Anglian Water's evidence include:

- Anglian Water's proposals for business separation appears to be driven, at least in part, by its business strategy rather than regulatory requirements and it has not properly justified the recovery of these costs through its default tariff controls.
- Any company intending to compete across the wider market needs to take particular care to show that business costs have been attributed and allocated properly and that business development costs are not inappropriately recovered from the base of customers that they have inherited from the previous monopoly arrangements. Anglian Water has provided no such analysis or assurance.

- Anglian Water has not explained what is different about its circumstances such that it is the only one of 17 incumbent companies to request higher cost allowances following the PR16 draft determinations.
- While Anglian Water has provided evidence that it is incurring certain extra costs there are a number of areas where it has not properly justified the increases. For example, it explains that its 2014-15 costs were higher than the base year costs allowed at PR14 as it filled vacancies and because of group-wide pay rises, without any explanation of why these factors were consistent with efficient operation. It also expects additional costs from new IT systems, but there is no explanation of why these initiatives appear to be failing to deliver operational efficiencies.
- Anglian Water has not provided substantial evidence to show that its costs are efficient or that it has fully engaged with its customers to discuss its proposals (particularly important given it is the only incumbent water company to request an increase in its overall cost allowance).

Drawing on the analysis outlined above, our overall assessment on Anglian Water's revised proposal is discussed in more detail in chapter 2.

Clear Business Water

Clear Business Water has not provided any evidence to demonstrate that the cost to serve and wholesale costs have not been allocated reasonably across company customer bases. The evidence that we have received from companies in support of changes to default tariff caps indicates that companies have improved their processes and approach to cost and margin attributions and allocations.

1.3 Overall allowances for business retail net margins

At PR14 we outlined that we would set an overall allowance for business retail net margins at 2.5% in the business retail price controls. Companies were, however, free to innovate and reduce their cost to serve (thereby increasing their overall net margin) or look to recover a lower net margin, should they consider it in their best interests to do so. In our statement of method we also indicated that in the absence of compelling evidence for a change in the overall net margin allowance, 2.5% was an appropriate return for securing the efficient financing of capital employed and remuneration of risk in providing competitive business retail services.

As part of their initial proposals for revised default tariff caps, companies did not provide any evidence in support of a need for higher margins for the competitive market. Following representations from Business Stream we considered and rejected the need to increase the net margin to cover the revised credit terms developed as part of retail market opening as:

- Business retailers would seek to adopt the most cost effective option or options available to them, which could include accessing finance on relatively favourable terms due to being part of a business that would have access to investment grade credit ratings.
- The overall net margin allowance of 2.5% was derived primarily from comparisons with other sectors and that evidence from companies cost/margin allocation models suggests that allocations relating to return on capital, working capital/credit costs and risk do not account for the whole of the 2.5% margin and that there is remaining unallocated margin.
- Companies have the opportunity to earn higher net margins by innovating and or reducing the cost to serve.

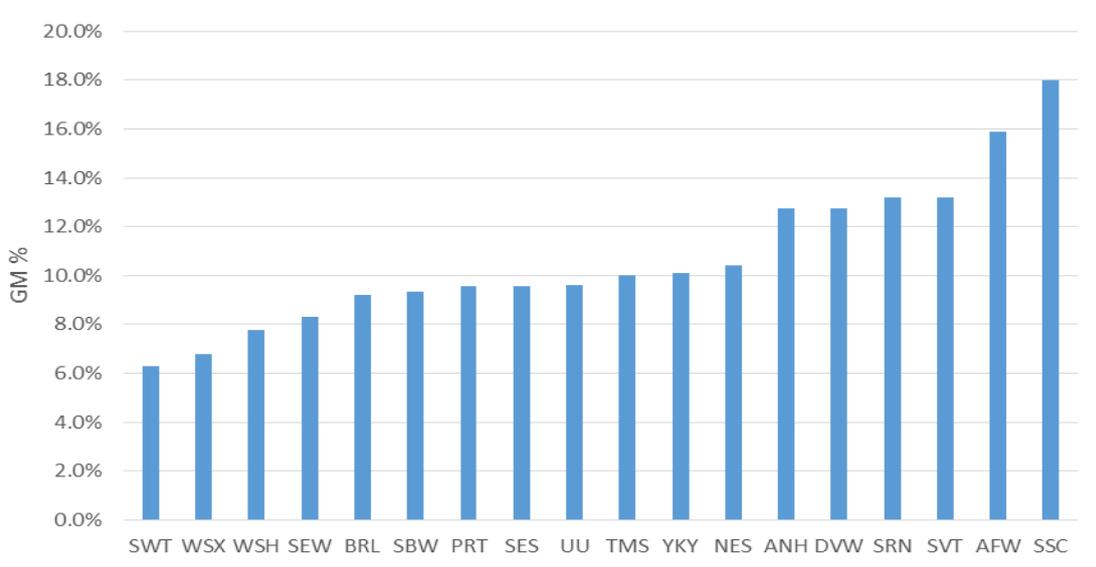
In response to our draft determinations we received one representations on net margins. Clear Business Water was concerned that there is insufficient margin to cover the credit options available for new retailers and that the margin is only sufficient for incumbent retailers who have access to investment grade credit ratings via their parent company. We note that Clear Business Water's representation provided no further evidence on these matters.

In the development of our draft determinations we considered a range of evidence on the net margin and the average cost to serve. We note that the CMA's energy market investigation identified concerns in the small and medium sized business market and the microbusiness⁷ business market in particular. In addition we have already seen a range of potential new entry into the business retail market with proposals for Thames Water and Portsmouth Water to exit to Castle Water and Southern Water to exit to Business Stream as well as a range of companies applying for new retail licences. Consequently we are not minded to amend the gross margin allowed at this stage. The PR16 price controls apply for three years and through the Retail Exit Code, apply to customers that are transferred as part of retail exit as well

⁷ A microbusiness is a business with less than 10 employees.

as to all small and medium sized business customers in a retail exit area. We will review the provisions in the Retail Exit Code in three years.

Figure 1.3 Company gross margins – water 0 to 5MI



Dŵr Cymru also made representations on the net margin applicable in Wales (1%), reflecting the different circumstances applying to companies operating wholly or mainly in Wales. Dŵr Cymru considered that a 1% net margin for non-contestable customers to be too low. This and other related aspects of its revised proposal are discussed in chapter 2.

1.4 Form of control and simplification

1.4.1 Overall approach to simplification

In the statement of method we explained that we would simplify the price control arrangements for larger customers (those using at least 5MI of water or wastewater per year in England and those using at least 50MI of water per year in Wales).

Our approach to simplification involved:

- Moving from regulating the allocation of costs/margins between tariff controls for individual companies to setting a sector-wide uniform gross margin cap for all customers in the 5 to 50MI water or wastewater per year band and for all customers in the at least 50MI water or wastewater per year band.

- A supplementary limit (or restraint) on price increases where companies existing tariffs are below the level implied by the gross margin cap (see section 1.5 below).

From April 2017, when our gross margin caps will apply, large customers will be able to choose their retailer on the basis of price and service offerings and so do not require protection at the individual company specific tariff band. Companies will still need to comply with their obligations under competition law. Recognising the different levels of retail competition permitted, for companies operating wholly mainly in Wales, gross margin caps will only apply to customers using at least 50MI of water per year.

At draft determinations we set these uniform gross margin caps at a level that would not constrain the recovery of reasonable costs by calibrating the gross margin cap at the maximum level of cost reflective gross margin (excluding companies that could not justify their proposed gross margins).⁸

We have concluded that the gross margin caps proposed at draft determination remain appropriate for our final determinations. Table 1.1 (below) outlines our uniform gross margin controls (and backstop protection) for customers using at least 5MI of water or wastewater per year. Details on the calculation of the final gross margin controls are detailed in the sections 1.4.2 to 1.4.5 below.

Table 1.1 Final uniform gross margin controls for PR16

Volume (mega litres per year)	Water (includes mixed use & non-potable water)	Wastewater (includes trade effluent & surface water drainage)
5 to 50	5.0%	5.3%
50 and over*	3.3%	2.8%

* In Wales the gross margin cap only applies to customers using at least 50MI of water per year.

⁸ Business retail price review 2016: Draft Decision

1.4.2 Water 5 to 50 mega litres uniform gross margin cap

Our draft determinations for the 5MI to 50MI water per year gross margin cap took into account gross margins in the range from 1.5% to 5% as shown in figure 1.5 below.⁹ Anglian Water's submission appeared to suggest a higher margin but we disregarded this due to concerns with the evidence it provided on costs and the transparency and accuracy of its data tables.

With the exception of Anglian Water, no company made representations on the uniform gross margin cap we outlined in the draft determinations for water 5 to 50MI. Anglian Water indicated that the extra costs it incurs for the extra services it provides in relation to its Maximum Daily Demand (MDD) tariffs would support a gross margin of 6.8% for the 5MI to 50MI water per year gross margin cap. As we explained in section 1.2, we have rejected Anglian Water's suggestion for an increase in its overall cost allowances. Nonetheless, we have given careful consideration to its representation that the gross margin cap for 5MI to 50MI water per year customers should be increased from the 5% we set in our draft determination.

Anglian Water indicated that it provides extra services to its MDD customers – including monitoring their daily demand and providing advice to customers that exceed their maximum agreed daily consumption. We understand Anglian Water's explanation of these matters and support the provision of extra services to customers where these are consistent with the interests of customers.

Nonetheless, our analysis of Anglian Water's revised proposal revealed that it was suggesting a 149% increase in the cost per customer allowance between 2016-17 and 2017-18 for its main MDD tariff. In response to our questions on these matters, Anglian Water explained that it had revised its approach to cost allocation and its previous approach 'in retrospect appears to have resulted in an under allocation to this class of customer'¹⁰.

The overall gross margin cap appropriate for this band of customers is sensitive to the assumptions made on cost allowances. For example, removing its proposed 31% overall increase in costs (discussed above in section 1.2) on a pro-rata basis from

⁹ These were set on the basis of information provided for 2017-18.

¹⁰ Email from Anglian Water of 16 November 2016.

the cost allowances that Anglian Water suggested for this group of customers would reduce the gross margin for this particular tariff from 6.8% to 5.7%.

We have considered five factors in deciding whether or not to increase the gross margin cap for the 5 to 50 MI water per year band on the basis of the evidence provided by Anglian Water:

- Anglian Water has not changed the services it provides to these customers over the period.
- The process and evidence Anglian Water has provided in support of its additional cost estimates have significant short-comings. In particular, where a company is suggesting a very significant change to cost allowances from historical levels it should highlight and fully explain this in its submission. It is disappointing that this was not the case in respect of Anglian Water's submission and that these matters only came to light through our analysis of the detail of its submission.
- We have concerns about the robustness of Anglian Water's overall cost projections and the allocation of these cost increases to its existing customer base. Adjusting its estimates of costs for this gross margin band on a pro-rata basis to remove its proposed 31% increase in overall costs (see section 1.2), reduces its gross margin from 6.8% to 5.7% – illustrating the sensitivity of its gross margin estimates to contentious assumptions on cost allowances.
- We have concerns about the stability and reliability of Anglian Water's cost allocations and estimates. A change of 149% in a period of a few years is very significant and appears to indicate a degree of volatility in Anglian Water's estimates.
- Anglian Water did not provide any evidence of customer engagement on the expected impact of this significant reallocation.
- Anglian Water is a clear outlier in terms of the allocations of costs and margins to customers using 5MI to 50MI water per year. Most incumbent companies are suggesting gross margins of less than 3.5% and on this basis a 5% gross margin cap (consistent with the highest proposal of the 16 other incumbent companies) looks relatively generous.

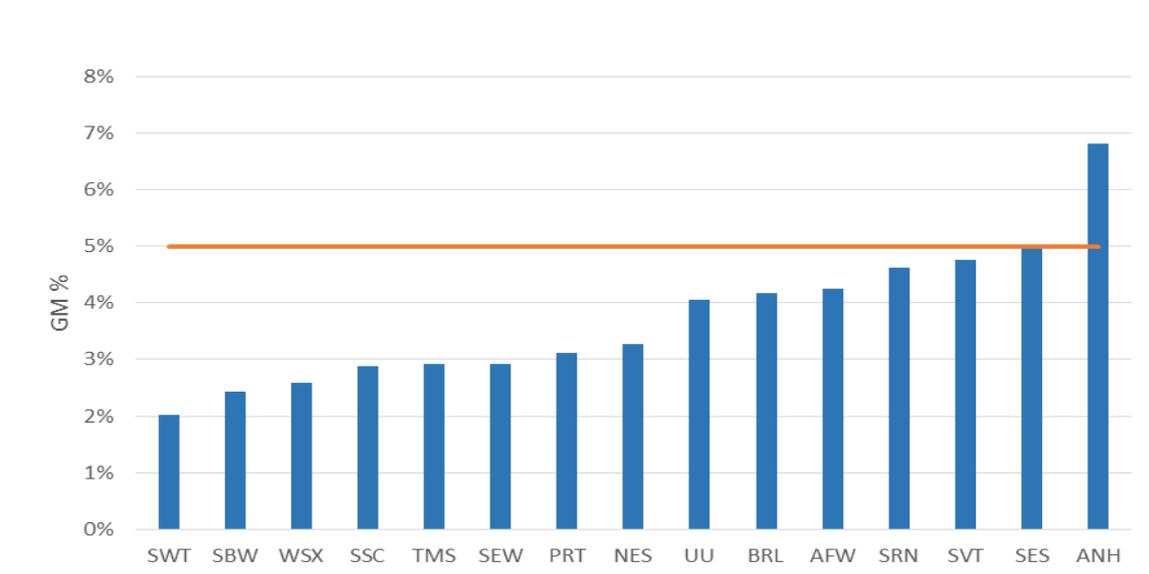
Taking into account all of the above suggests that, despite the extra services offered with its MDD tariffs, the costs estimates provided by Anglian Water do not constitute the sufficiently solid and reliable evidence necessary to justify an increase in a sector-wide price restraint (set by the uniform gross margin cap), particularly in the

absence of specific customer engagement and support. Further information on our overall assessment of Anglian Water’s revised proposal is available in chapter 2.

We have therefore decided to retain the approach set out in our draft determinations and our final determinations are based on the maximum cost reflective gross margin cap of 5.0%. This will apply to all companies operating wholly or mainly in England.

In Wales, where the market for customers using 5MI to 50MI water is not contestable, a non-contestable net margin of 1% will apply to Dee Valley Water and Dŵr Cymru. Above 50MI, where the water market (but not the wastewater market) is contestable, a net margin of 2.5% will apply to Dee Valley Water and Dŵr Cymru. This issue is discussed in more detail in chapter 2.

Figure 1.5 Company final gross margins – water 5 to 50MI



Note: No companies wholly or mainly in Wales are included in this figure as water supply less than 50MI per year is not contestable in Wales.

1.4.3 Wastewater 5 to 50 mega litres uniform gross margin cap

Our draft determinations for the gross margin cap for the 5MI to 50MI wastewater per year band took into account company proposals for gross margins that ranged from 1.5% to 5.3%, as shown in figure 1.6 below.¹¹ Anglian Water appeared to have a

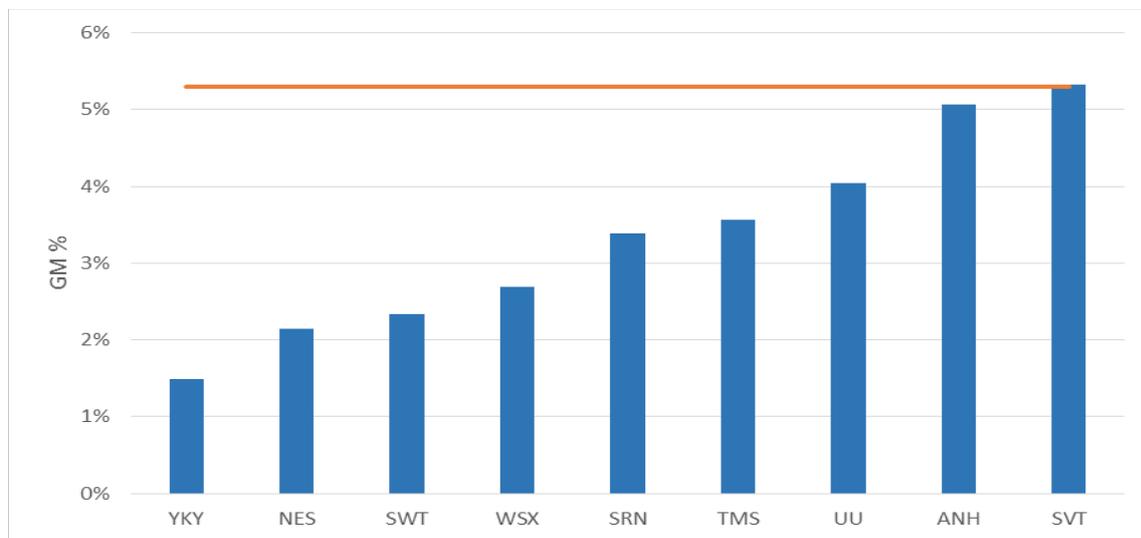
¹¹ These were set on the basis of information provided for 2017-18.

higher margin but as per the discussion in 1.4.2 (above), its overall cost proposals as well as the cost estimates provided for the MDD tariffs included in this band did not constitute sufficiently solid and reliable evidence necessary to support their proposal. We therefore disregarded its higher gross margin for wastewater 5 to 50 MI due to concerns about its proposals for cost increases and a lack of transparency with respect to its data tables, and a lack of specific customer engagement and support.

In responding to our draft determinations no company, including Anglian Water, made representations on the 5.3% cap on this gross margin band. Consistent with our draft determinations, our final determinations are therefore based on the maximum cost reflective gross margin that was sufficiently supported by evidence of 5.3%. This will apply to all companies operating wholly or mainly in England.

In Wales, where wastewater customers are not eligible to participate in the competitive market a non-contestable net margin of 1% will apply to Dŵr Cymru (noting that Dee Valley Water is a WOC and does not provide wastewater services). This issue is discussed in more detail in chapter 2.

Figure 1.6 Company final gross margins – wastewater 5 to 50MI



Note: No companies operating wholly or mainly in Wales are included in this figure as wastewater is not contestable in Wales.

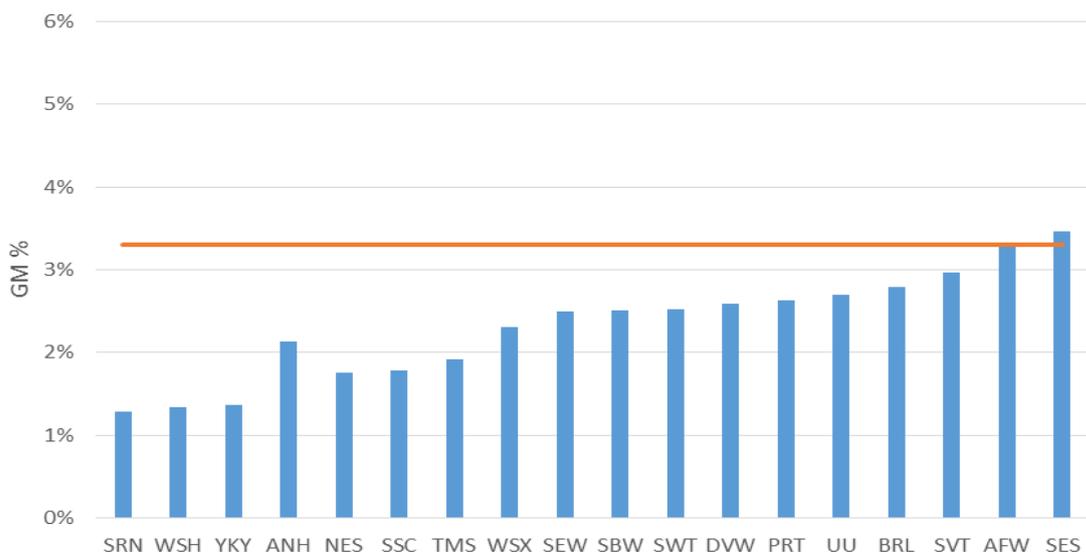
1.4.4 Water supplies 50 mega litres and over uniform gross margin cap

Our draft determinations for the gross margin cap on the at least 50MI water per year band took into account company proposals for gross margins that ranged from 1.3%

to 3.3% as shown in figure 1.7 below.¹² While Sutton and East Surrey Water proposed a gross margin of 3.5% for 2017-18, it had proposed lower margins of 2.9% for 2018-19 and 2019-20. As all other companies had a gross margin of no more than 3.3% we therefore used the 3.3% as the maximum level to all the companies operating wholly or mainly in England and Wales (as customers of all companies using more than 50MI of water will have access to water business retail market).

In responding to our draft determinations no company, including Sutton and East Surrey Water, made further representations on these matters. Our final determination is therefore to retain a gross margin cap of 3.3%. This will apply to all the companies operating wholly or mainly in England and Wales, as all customers of companies using at least 50MI water per year will have access to the water business retail market.

Figure 1.7 Company final gross margins – water supplies 50MI and over



1.4.5 Wastewater services 50 mega litres and over uniform gross margin cap

Our draft determinations for the gross margin cap on the at least 50MI per year wastewater band took into account company proposals for gross margins that

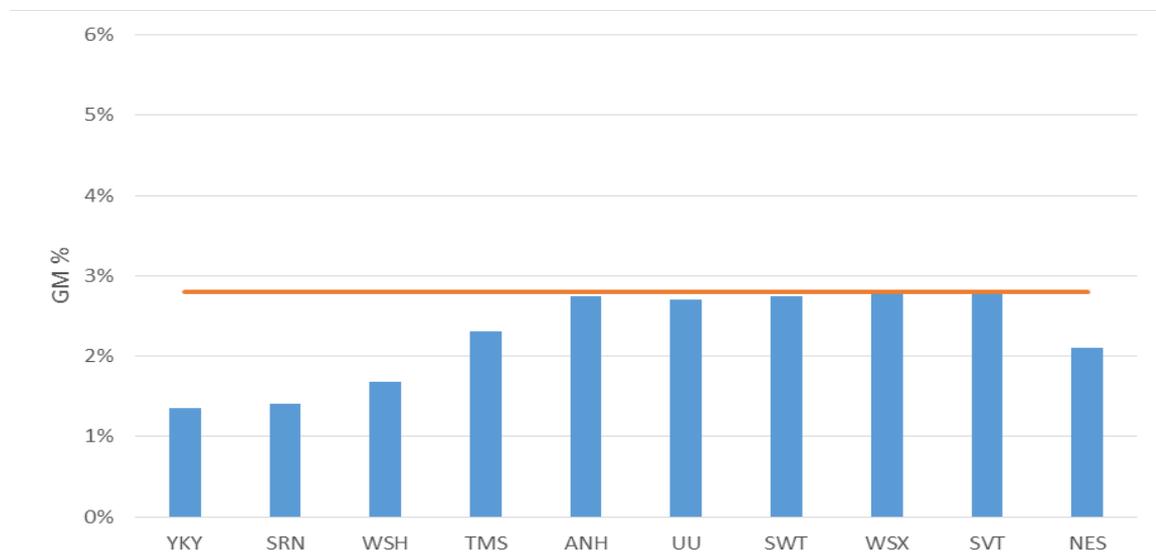
¹² These were set on the basis of information provided for 2017-18.

ranged from 1.3% to 2.8% as shown in figure 1.8 below.¹³ While Northumbrian Water’s proposal for gross margin was 11.3%, we had concerns about the accuracy of its data tables, particularly in respect of this band. For all other companies the gross margin was no more than 2.8% (which is the level proposed by Severn Trent for the allocation of costs and margins to wastewater customers using more than 50 MI per year) and so this was the cap we set for this band for all the companies operating wholly or mainly in England.

In responding to our draft determinations no company made representations on the 2.8% cap on this gross margin band. Consistent with our draft determinations, our final determinations are therefore based on the maximum cost reflective gross margin of 2.8%. This will apply to all companies operating wholly or mainly in England.

In Wales, where wastewater customers are not eligible to participate in the competitive market a non-contestable net margin of 1% will apply to Dŵr Cymru (noting that Dee Valley Water is a WOC and does not provide wastewater services). This issue is discussed in more detail in chapter 2.

Figure 1.8 Company final gross margins – wastewater services 50MI and over



¹³ These were set on the basis of information provided for 2017-18.

1.5 Supplementary restraint on price increases

As highlighted in our draft determinations, there is considerable variation between how companies have allocated the gross margin across tariffs that are captured in the gross margin caps for the different bands detailed above (see figures 1.5 to 1.8).

It is likely that these larger customers will be best able to take advantage of competition and that competition will drive margins in this segment of the market. Nonetheless, to prevent any undue price disturbance at market opening we have proposed a supplementary restraint on price increases. This restraint will be applied to company proposals to increase existing tariffs for business customers using at least 5Ml of water or wastewater per year that would close the headroom between the cost reflective default tariff caps they proposed and the gross margin caps. Any increases that involve reducing this headroom should not lead to a price increase of more than 1% in the final bill for any customer type in any year.

The supplementary restraint only applies to the tariffs applying to customers that have not chosen to pay different charges to those that they would otherwise be liable for and that are using at least 5Ml of water or wastewater per year. It also only relates to increases in the gross margin that close the headroom between the gross margin the company proposed and the gross margin cap.

Charges may increase by more than 1% for other reasons – such as increases in wholesale charges. These changes will also continue to be governed by our [charges scheme rules](#), which include obligations on companies to have appropriately engaged their stakeholders in developing their charges and to have considered appropriate transitional arrangements.

1.6 Eligibility and the Regulatory Accounting Guideline

At draft determination eleven companies proposed changes to the number of eligible customers. We assessed those proposals to determine whether appropriate adjustments to aggregate business retail costs had been made by companies to recognise that some of those costs may now be recovered through the residential retail control as a consequence of changes in eligibility.

For the customers of South West Water in the Bournemouth area we made an adjustment to its draft determination proposals to remove £50,000 in cost allowances

to properly reflect changes in its numbers of customers.¹⁴ We note that South West Water has subsequently accepted this adjustment (see chapter 2).

At draft determinations we also recognised that the Regulatory Accounting Guideline (RAGs) presently use the residential and business definitions in place at PR14. So to use the automatic adjustment mechanisms in the price controls to deal with changes in the eligibility criteria we will need to update the definition of customers used in the RAGs so that it reflects the thinking outlined in our consultation on [revised eligibility guidance](#). We indicated that updating the definition of customers used in the RAGs seemed an appropriate way forward.

In its response to our draft determinations, Sutton and East Surry requested a commitment from Ofwat that the RAGs will be updated to reflect the automatic control mechanism whereby customers that are not eligible for the business retail control will be considered in the residential retail control for the purposes of calculating retail costs. We note Sutton and East Surry's request and that our intention remains to update the definition of customers used in the RAGs at the next available opportunity.

1.7 Publication of information

Following the draft determination, representations were made that we should publish the gross margins for the average revenue controls per customer type for each tariff structure for customers using less than 5MI of water or wastewater per year (who make up the majority of the market), to enable comparisons of the gross margins available across different incumbent areas in advance of charges schemes being published in February 2017.

We agree that publication of this information on average revenue controls will increase transparency across the market and assist new entrants to the market for the benefit of customers. We also consider that this information would help to explain our final determination. We have therefore published additional information on each of the tariffs provided by the companies as part of our final determination.

¹⁴ This adjustment was made because its customer numbers were reduced by more than 10% but it did not reduce its overall business retail cost allowance to reflect the additional costs that will be recovered through the residential retail control.

2. Final determinations

This chapter builds on chapter 1 and sets out our final determinations for those companies that:

- accepted our draft determinations (section 2.1); and
- provided additional information and/or revised PR16 company proposals in response to our draft determinations (section 2.2).

In setting out our final determinations we have considered the specific issues that companies have identified and drawn on the information set out in chapter 1.

2.1 Companies that accepted our draft determinations

Twelve companies (including South West Water that made separate proposals for the South West and Bournemouth areas) accepted our draft determinations. This included our proposed modification of South West Water's proposal for Bournemouth Water.¹⁵

The Consumer Council for Water agreed with these draft determinations but noted that where company proposals result in price increases for customers that companies engage their customers to explain these changes and any significant price increases should be phased in. None of the changes arising from the PR16 determinations for these companies should lead to significant price increases for customers.

Bearing the above in mind we intend to make final determinations for these 12 companies on the same basis as their draft determinations. The companies concerned are listed below:

- Affinity Water;
 - Bristol Water;
-

¹⁵ Our modification of South West Water's proposal for the Bournemouth area involved a £50,000 downward adjustment applied proportionately to the retail cost allowances across the default tariff caps for customers with volumes less than 5MI of water. The intention of this modification was to both protect customers from the recovery of unnecessary costs and from price increases not reasonably supported by customer engagement.

- Dee Valley Water;
- Portsmouth Water;
- Severn Trent Water;
- South East Water;
- South Staffordshire;
- South West Water (for both its South West and Bournemouth areas);
- Southern Water;
- Sutton and East Surrey Water;
- United Utilities; and
- Wessex Water.

The key tables that will be used in the formal determination notifications of the new price controls for these companies are in appendix 1.

2.2 Assessment of additional information and revised PR16 company proposals

Following the publication of our draft determinations five companies submitted new evidence in support of their PR16 proposals:

- Yorkshire Water;
- Anglian Water;
- Dŵr Cymru;
- Northumbrian Water; and
- Thames Water.

Each of these five companies is discussed further below.

2.2.1 Yorkshire Water

Draft determination

Our draft determination for Yorkshire Water relied on its PR16 proposals for the less than 5MI per year water and wastewater default tariff caps conditional on receiving appropriate transparency and reassurance on bill impacts for customers using less than 5MI of water or wastewater per year. Yorkshire Water was required to provide appropriate additional information before we would be able to confirm acceptance of its PR16 proposals.

Responses to our draft determination

In response to our draft determination Yorkshire Water has provided additional information on its costs and cost drivers, its approach to cost allocation and margins, and the expected impact of its proposals on small customers.

The Consumer Council for Water noted that it expected Yorkshire Water to provide the information we requested. It also noted its expectations that no customers will see increases higher than 5% and that Yorkshire Water will effectively engage its customers ahead of retail market opening.

Our assessment

Yorkshire Water has provided evidence that shows the expected bill impacts of its proposals are less than 1% and we consider the evidence that it has submitted in support of its PR16 proposals sufficiently robust that we confirm that we will use its proposals to make our final determinations.

Final determination

We have accepted Yorkshire Water's PR16 proposals for the default tariff caps for customers consuming between 0 to 5MI of water and wastewater per year. We will apply our uniform gross margin controls for those customers using at least 5MI per year of water or wastewater. We will also apply the 1% supplementary restraint on price increases for customers within the uniform bands.

2.2.2 Anglian Water

Draft determination

Our assessment of Anglian Water's PR16 proposal was that it had not provided sufficiently robust supporting evidence to support its proposal. Specific concerns included:

- **Quality of evidence submitted:** we were concerned that the evidence submitted in support of a significant increase in the overall cost allowances did not meet the test of substantial new evidence as described in our statement of method. We were also unable to reconcile its narrative with the information contained in its data tables.

- **Expected bill impact:** while we welcomed Anglian Water's discussion of the expected impact of its proposal on customers' bills with its Customer Engagement Forum, where customers are expected to be significantly impacted then we would have expected its proposals to be accompanied by evidence of direct customer engagement.

We also noted that Anglian Water had raised concerns that following our statement of method would put it at risk of breaching competition law. We explained that it is for each company to ensure that it complies with all relevant legal obligations, including competition law and that any competition law risks associated with each company's pricing decisions rest with the company concerned.

Responses to our draft determination

In response to our draft determination Anglian Water has:

- Provided an explanation for the additional business retail costs that it considers appropriate together with external assurance.¹⁶
- Proposed that the gross margin cap for water customers consuming 5 to 50MI per year should be 6.8% (rather than the 5% we proposed in the draft determinations) as it has extra costs from the operation of its MDD tariffs and the provision of additional advice to customers on these matters.
- Provided information on the expected bill impacts of their revised proposals for different customer classes.
- Acknowledged the points we made on competition law, including that it was for it to ensure compliance with competition law.

The Consumer Council for Water noted that Anglian Water needed to provide sufficient justification for proposed cost increases and if these were accepted by us

¹⁶ Two-thirds of the proposed increase in retail costs that Anglian Water has suggested for 2015-16 relate to establishing new retail business premises (eg staffing, accommodation, IT, telephony and other systems). Additional costs to be incurred in 2016-17 include depreciation above the PR14 allowance for new non-household retail assets acquired in 2015-16; additional staff and on-going operating costs associated with the new billing system.

then Anglian Water should engage with affected customers and phase in any increases.

Our assessment

We welcome the additional information that Anglian Water has provided in response to our draft determinations and the additional comments it has made on compliance with competition law.

However, as we have explained in section 1.2, where we discussed the overall allowances for business retail cost to serve, the information that Anglian Water has provided on its cost increases has not persuaded us to increase its overall allowance for costs. This is because we are not convinced that the extra costs should be recovered from its default tariff caps or that the costs are being efficiently incurred.

Furthermore, as we have explained in section 1.4, where we discussed the form of control and simplification, the lack of evidence to support its claim for extra costs associated with its MDD tariffs, including with respect to customer engagement, is not sufficient for us to increase the 5MI to 50MI per year gross margin water cap from 5% to 6.8%.

Having considered the evidence submitted in response to our draft determination (as outlined in sections 1.2 and 1.4) we therefore consider that Anglian Water has not provided sufficiently robust evidence to support its revised PR16 proposals.

Final determination

Consistent with our draft determinations we have decided to retain Anglian Water's PR14 price controls for customers using less than 5MI water or wastewater per year for its final determinations. For customers using at least 5MI water or wastewater per year the uniform gross margin controls will apply. We will also apply the 1% supplementary restraint on price increases for customers within the uniform bands.

2.2.3 Dŵr Cymru (Welsh Water)

Draft determination

Our assessment of Dŵr Cymru's proposal was that it had not provided sufficiently robust evidence to support its PR16 proposals. Specific concerns were:

- **Allocation of costs and margins:** there was a lack of information supporting Dŵr Cymru's allocation of costs/margins so we were unclear as to why, for example, costs allocated to customers using at least 50MI of water per year had fallen significantly and why total retail costs have not fallen in line with the reductions in expected customer numbers. We were also not convinced by its arguments that it should be able to smear the recovery of competitive margin across its contestable and non-contestable customer base – even if the price impact on smaller customers is relatively modest.
- **Expected bill impact:** further information was required on the expected impact of its proposals on customer bills.

Responses to our draft determination

In response to our draft determination Dŵr Cymru has:

- Provided information that outlines its new approach to cost allocation – an approach made possible by improved cost information from a new billing system.
- Explained how the expected fall in customer numbers in its business market is not due to the movement to the residential market but is due to better data, and provides an explanation as to why its total retail costs should not be adjusted downward.
- Explained that we had not characterised its PR16 proposals in our draft determinations in the way it had intended and that its PR16 proposals were to reflect that an appropriate allowance for retail margins was more likely to relate to retail cost to serve rather than turnover, and on this basis its PR14 net margins for smaller customers may be too low and for larger customers the margins may be too high.
- Resubmitted its default tariffs with margins at 2.5% for contestable customers and 1% for non-contestable customers. It notes it continues to consider a 1% net margin for non-contestable customers to be too low.
- Provided information on the expected bill impacts of its proposals on customers' bills.

The Consumer Council for Water noted that Dŵr Cymru had failed to provide sufficient evidence to support its proposals and agreed with our draft determination for Dŵr Cymru.

Our assessment

We note that Dŵr Cymru accepted a 1% net margin as the basis for its residential retail control at PR14 for the duration of the 5 year control and that it has not provided any new evidence that supports this issue being reconsidered at this time. Bearing this in mind, the most appropriate opportunity to reconsider issues around the margin for non-contestable customers will be at the review of the monopoly retail controls during PR19. On this basis we have focused attention on the proposals set out in its data tables that use a non-contestable margin of 1% and a contestable margin of 2.5%.

It has now provided sufficient evidence to explain its approach to cost allocation. It has also provided convincing evidence on how it has apportioned its costs and why a reduction in customer numbers should not be accompanied by a reduction in its overall cost allowance.

Sufficient evidence has also been provided to allow us to understand the expected bill impacts of its proposals. Nearly all its customers (with the exception of a relatively few small sewerage customers) are expected to experience a small decline in their bills. And, while Dŵr Cymru has not provided evidence on customer engagement with the small sewerage customers that will face a bill increase, given the magnitude of the expected increase and the relatively few customers affected, we have accepted this aspect of its proposal.

Having considered the evidence that Dŵr Cymru has submitted we now consider that it has provided sufficiently robust evidence to support its revised PR16 proposals.

Final determination

We have accepted Dŵr Cymru's revised PR16 proposals for the default tariff caps for customers consuming between 0 to 50MI of water per year. We will apply our uniform gross margin controls for those customers using at least 50MI of water per year. The 1% supplementary restraint on price increases for customers within the uniform bands will also apply.

2.2.4 Northumbrian Water

Draft determination

Our assessment of Northumbrian Water's proposal was that it had not provided sufficiently robust evidence to support its PR16 proposals. Specific concerns were:

- **Allocation of costs and margins:** only limited information was provided to support its changes in cost allocations so we remained unclear as to how it had allocated its costs and margins to customers in the 0 to 5MI per year and 5 to 50MI per year bands.
- **Expected bill impact:** further information was required on the expected impact of its proposals on customer bills. The information provided appeared to suggest increases to small unmeasured customers in its Southern region and it was not clear whether these were supported by customer engagement.
- **Quality of evidence submitted:** there appeared to be a quality assurance issue with the data tables provided – including in relation to wastewater, where it appeared to be suggesting a relatively large number of very large customers.

Responses to our draft determination

In response to our draft determination Northumbrian Water has provided:

- Information that clarifies its approach to allocating costs and margins for PR16, which is the same as that used at PR14.
- A more detailed breakdown of the expected bill impact on different customer groups (including that the overall impact on all its customer types when considered as a whole suggests low or negative price changes).
- A corrected data table, together with an explanation as to why the quality assurance process undertaken in preparing its initial submission to us did not identify this issue, and the steps it has taken to ensure similar events do not re-occur.

The Consumer Council for Water noted that it had been in contact with Northumbrian Water and that it expected Northumbrian Water to submit more information to us in response to our draft determination. It also highlighted its expectations, assuming that we accepted Northumbrian Water's evidence, that Northumbrian would explain

any customer bill increases to its customers, and that any significant bill increases would be phased in.

Our assessment

We consider that following its submission of its revised PR16 proposal, Northumbrian Water has now provided sufficient quality evidence on its costs allocation. Northumbrian Water has also provided information on the expected bill impacts for different customer types. While there is a lack of customer engagement on the expected bill impacts, this is acceptable given the modest materiality of the expected increases.¹⁷ The quality assurance issue with the data tables has been addressed and we welcome the steps that it has taken to ensure similar events do not re-occur.

Having considered the evidence submitted in response to our draft decision we now consider that Northumbrian Water has provided sufficiently robust evidence to support its revised PR16 proposals.

Final determination

We have accepted Northumbrian Water's revised PR16 proposals for the default tariff caps for customers consuming between 0 to 5MI of water and wastewater per year. We will apply our uniform gross margin caps for those customers using at least 5MI. We will also apply the 1% supplementary restraint on price increases for customers within the uniform bands.

2.2.5 Thames Water

Draft determination

Our assessment of Thames Water's proposal was that it had not provided sufficiently robust evidence to support its PR16 proposals, which included revising its methodology for the net margin from a flat 2.5% margin across all tariffs to allocating the margin based on cost drivers. Specific concerns were:

¹⁷ The expected impact on customer bills is below 1% except for the one groups of less than 5MI customers in one region. However, when customer types have aggregated across regions the total impact of this group is well below 1%.

- **Allocation of costs and margins:** while Thames Water has sought external assistance to assist it in revising its net margins and it has gained other external assurance of its approach (including a review of compliance with the approach we outlined in our statement of method and Thames Water's internal governance arrangements), there remained a lack of transparency with respect to evidence that would support the actual changes.
- **Expected bill impact:** although Thames Water has estimated the expected impact of its proposals on customers' proposed bills, and it has undertaken some customer engagement, there are shortcomings in how its evidence supports its proposed bill increases. For instance, it appeared that its proposed bill increases were sometimes more than twice the level of the £10 increase (for combined bills) that had been accepted by customers as being reasonable.

Responses to our draft determination

In response to our draft determination Thames Water has:

- Reviewed and provided more information on its approach to allocating net margins across tariff bands – its approach is based on cost drivers (working capital and return on investment).
- Provided more information on its revised cost allocations which involves altering bad debt management costs to be more cost reflective.
- Undertaken work on the expected impact of its proposals on customer bills and has undertaken further customer engagement.¹⁸

The Consumer Council for Water supported our draft determination due to a lack of customer engagement that Thames Water had undertaken on the expected bill increases.

¹⁸ The combination of its revised margin allocations and cost allocation results in significantly reduced bill impacts for small customers in the 0 to 5MI per year range from up to 3.9% based upon its draft determination submission to less than 0.5% for most customers except for some customers in the 0.5 to 1MI per year customers who will experience a bill increase of around 1.5% increase as a result of the proposed changes (these customer represent around 10% of the customer base).

Our assessment

Thames Water's revised proposal is more transparent and it has provided sufficient evidence to support both its methodology in allocating the net margin across tariff bands and the change in cost allocation across its tariff bands.

Thames Water has also undertaken additional customer engagement which supports its revised proposals (which involves more moderate bill impacts for smaller customers and some customers in the 0 to 5MI per year range experiencing bill impacts of around 1.5%).

Having considered the evidence submitted in response to our draft decision we now consider that Thames Water has provided sufficiently robust evidence to support its revised PR16 proposals.

Final determination

We have accepted Thames Water's revised PR16 proposals for the default tariff caps for customers consuming between 0 to 5MI of water and wastewater per year. We will apply our uniform gross margin caps for those customers using at least 5MI per year. We will also apply the 1% supplementary restraint on price increases for customers within the uniform bands.

A1 Company tables

In the following sections we outline the tables we have used in the final determinations for PR16 that we have published alongside this document. The units used in the tables below are:

r_c (£) = the allowed average retail cost component for a given customer type (in pounds);

m % = the allowed net margin for a given customer type (expressed as a percentage); and

g_m % = the allowed gross margin for a given customer type (expressed as a percentage).

We note that from April 2017, incumbent water companies whose areas are wholly or mainly in England can exit the business retail business and no longer provide retail services for business retail customers. Instead these customers can be transferred to a separate retailer, which can be an associated retailer (part of the same group) or a separate retailer. Where this occurs, the Retail Exit Code requires that for transferred customers the retailer will need to continue to comply with our business retail price controls unless these customers have negotiated a contract with the retailer concerned. The Retail Exit Code also applies the price controls to any small and medium sized business customers in an area where the incumbent water company has exited the retail market.

A1.1 Affinity Water Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
AFW Metered 0-5 MI, including assessed customers and unmeasured RV customers	r_c (£)	47.45	46.38	45.12
	m %	2.94%	2.94%	2.94%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	gm %	5.0%	5.0%	5.0%
Water supplies 50 MI and over	gm %	3.3%	3.3%	3.3%

A1.2 Anglian Water Services Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Unmeasured (potable water)	r _c (£)	14.70	14.70	14.69
	m %	3.72%	3.72%	3.72%
Hartlepool Unmeasured (potable water)	r _c (£)	12.33	12.32	12.31
	m %	4.86%	4.83%	4.80%
Streamline Green (potable water) - (0.0MI to 0.5MI)	r _c (£)	34.32	34.28	34.24
	m %	4.57%	4.55%	4.53%
Streamline Orange (potable water)-(0.5MI to 5.0MI)	r _c (£)	92.00	91.94	91.88
	m %	2.29%	2.29%	2.29%
Streamline Orange (non-potable) - (0.5MI to 5.0MI)	r _c (£)	67.07	67.12	67.17
	m %	2.57%	2.55%	2.54%
Unmeasured (sewerage)	r _c (£)	15.60	15.61	15.61
	m %	3.31%	3.31%	3.32%
Streamline Green (Sewerage – (0.0ML to 0.5MI)	r _c (£)	32.60	32.59	32.57
	m %	3.59%	3.59%	3.58%
Streamline Orange (sewerage) – (0.5MI to 5.0MI)	r _c (£)	49.11	49.02	48.93
	m %	1.56%	1.56%	1.57%
Unmeasured (Trade Effluent)	r _c (£)	18.94	18.89	18.84
	m %	3.48%	3.44%	3.40%
Streamline Green (trade effluent) – (0.0MI to 0.5MI)	r _c (£)	173.41	172.71	171.96
	m %	7.13%	7.04%	6.93%
Streamline Orange (Trade Effluent) - (0.5MI to 5.0MI)	r _c (£)	153.27	152.54	151.76
	m %	3.73%	3.68%	3.62%
*Hartlepool Commercial (potable water) - (0.0MI to 50.0MI)	r _c (£)	27.45	27.45	27.45
	m %	3.64%	3.66%	3.68%

*Special Agreements (non-potable water) - (0.0MI +)	r _c (£)	426.44	426.64	426.87
	m %	0.69%	0.71%	0.73%
*Special Agreements (potable water) - (0.0MI +)	r _c (£)	426.44	426.64	426.87
	m %	0.76%	0.78%	0.80%

Tariffs marked with * are not necessarily allocated to the 0-5ML volume band, but there may be customers on that tariff who are so they have been included.

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	g _m %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	g _m %	2.8%	2.8%	2.8%

A1.3 Bristol Water plc

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Band F - 1-5MI	r _c (£)	42.48	42.69	42.91
	m %	1.80%	1.82%	1.84%
Band G - 0-1MI	r _c (£)	24.46	24.43	24.41
	m %	3.82%	3.74%	3.66%
Band U	r _c (£)	7.67	7.65	7.64
	m %	4.34%	4.20%	4.07%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%

A1.4 Dee Valley Water Plc

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Tariff band 01 - Unmeasured	r _c (£)	28.94	29.07	29.45
	m %	1.0%	1.0%	1.0%
Tariff band 02 – Measured less than 50MI	r _c (£)	31.62	31.75	32.11
	m %	1.0%	1.0%	1.0%
Tariff band 03 – Untreated measured less than 50MI	r _c (£)	29.90	29.90	29.90
	m %	1.0%	1.0%	1.0%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%

A1.5 Dŵr Cymru Cyfyngedig

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
< 50MI Water	r _c (£)	34.42	31.94	32.01
	m %	1.00%	1.00%	1.00%
Sewerage	r _c (£)	47.45	44.37	44.44
	m %	1.00%	1.00%	1.00%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
*Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%

*Water 50MI and over includes tariffs designated as special agreements at PR14.

A1.6 Northumbrian Water Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Unmeasured, Unmeasured Water, Unmeasured	r _c (£)	17.08	17.07	17.06
	m %	6.68%	6.68%	6.68%
Measured, Measured Water 0-5MI/yr, Measured	r _c (£)	28.11	28.09	28.06
	m %	4.00%	4.00%	4.00%
Unmeasured, Unmeasured Sew, Unmeasured	r _c (£)	18.00	17.98	17.97
	m %	4.36%	4.36%	4.36%
Measured, Measured Sew 0-5MI/yr, Measured	r _c (£)	30.16	30.13	30.10
	m %	2.56%	2.56%	2.56%

Tariffs marked with * are not necessarily allocated to the 0-5ML volume band, but there may be customers on that tariff who are so they have been included.

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	g _m %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	g _m %	2.8%	2.8%	2.8%

A1.7 Portsmouth Water Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Water Unmeasured Non-Household	rc (£)	16.67	16.71	16.72
	m %	2.28%	2.18%	2.19%
Water Measured Non-Household < 5MI	rc (£)	20.22	20.13	20.12
	m %	2.40%	2.40%	2.40%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	gm %	5.0%	5.0%	5.0%
Water supplies 50 MI and over	gm %	3.3%	3.3%	3.3%

A1.8 Severn Trent Water Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Water: Unmeasured and 0-5 MI/a	rc (£)	41.94	43.80	45.24
	m %	3.79%	3.86%	3.73%
Waste Water: Unmeasured and 0-5 MI/a	rc (£)	42.20	44.03	45.39
	m %	2.79%	2.82%	2.85%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	gm %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	gm %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	gm %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	gm %	2.8%	2.8%	2.8%

A1.9 South East Water Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Portable Water - Unmetered	r _c (£)	36.29	36.26	36.41
	m %	1.15%	1.14%	1.14%
Potable Water - Metered 0-2.5 MI/a	r _c (£)	35.58	35.97	36.42
	m %	2.73%	2.73%	2.73%
Potable Water - Metered 2.5-5 MI/a	r _c (£)	68.12	68.52	68.96
	m %	2.27%	2.27%	2.27%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%

A1.10 South Staffordshire Water Plc

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Unmeasured and measured 0-5 MI/a	r _c (£)	46.31	45.30	44.64
	m %	2.96%	2.96%	2.96%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%

A1.11 South West Water Limited

South West Area

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Standard Unmeasured Water	r _c (£)	13.58	13.53	13.26
	m %	1.94%	1.90%	1.87%
Standard Unmeasured Sewerage	r _c (£)	15.17	15.12	14.84
	m %	1.94%	1.90%	1.87%
Standard measured water <5MI	r _c (£)	16.02	15.97	15.70
	m %	3.14%	3.15%	3.13%
Standard measured sewerage <5MI inc TE	r _c (£)	15.36	15.36	15.21
	m %	2.77%	2.76%	2.74%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	g _m %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	g _m %	2.8%	2.8%	2.8%

Bournemouth Area

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Domestic Commercials unmetered	r _c (£)	16.28	15.69	14.81
	m %	1.89%	1.85%	1.82%
Standard measured water <5 MI	r _c (£)	23.05	22.43	21.51
	m %	3.02%	3.01%	3.01%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Water supplies 50 MI* and over	g _m %	3.3%	3.3%	3.3%

Water 50 MI and over includes the single special agreement customer for Bournemouth Water

A1.12 Southern Water Services Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Standard Water - Unmetered	rc (£)	12.29	12.41	12.41
	m %	2.16%	2.16%	2.17%
Standard 0-1ML p.a. Water Metered	rc (£)	23.30	23.52	23.52
	m %	6.30%	6.31%	6.32%
Standard 1-5ML p.a. Water Metered	rc (£)	81.43	82.19	82.20
	m %	2.83%	2.84%	2.84%
Standard Sewerage Unmetered	rc (£)	15.14	15.29	15.29
	m %	1.95%	1.95%	1.95%
Standard 0-1ML p.a. Sewerage Metered	rc (£)	25.48	25.72	25.72
	m %	3.62%	3.62%	3.62%
Standard 1-5ML p.a. Sewerage Metered	rc (£)	98.39	99.31	99.31
	m %	1.98%	1.98%	1.98%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	gm %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	gm %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	gm %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	gm %	2.8%	2.8%	2.8%

A1.13 Sutton and East Surrey Water Plc

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Unmeasured	r _c (£)	19.01	19.13	19.19
	m %	2.50%	2.61%	2.61%
0 to 5 MI measured	r _c (£)	29.48	29.66	29.76
	m %	2.50%	2.61%	2.61%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%

A1.14 Thames Water Utilities Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins*

Customer type	Units	2017-18	2018-19	2019-20
[0 - 500] [0 - 500m3] [water] [metered]	rc (£)	23.24	23.16	23.14
	m %	2.88%	2.88%	2.88%
[500 - 1,000] [500 - 1,000m3] [water] [metered]	rc (£)	47.93	48.85	47.95
	m %	2.85%	2.85%	2.85%
[1,000 - 5,000] [1,000 - 5,000m3] [water] [metered]	rc (£)	61.47	62.58	61.64
	m %	2.65%	2.65%	2.65%
[0 - 500] [0 - 500m3] [sewerage] [metered]	rc (£)	31.23	31.03	31.29
	m %	3.15%	3.15%	3.15%
[500 - 1,000] [500 - 1,000m3] [sewerage] [metered]	rc (£)	70.63	70.80	70.30
	m %	3.10%	3.10%	3.10%
[1,000 - 5,000] [1,000 - 5,000m3] [sewerage] [metered]	rc (£)	91.01	91.21	90.88
	m %	2.89%	2.89%	2.89%
[0 - 500] [0 - 500m3] [trade effluent] [metered]	rc (£)	31.91	31.72	31.96
	m %	3.39%	3.39%	3.39%
[500 - 1,000] [500 - 1,000m3] [trade effluent] [metered]	rc (£)	63.44	63.50	63.19
	m %	3.32%	3.32%	3.32%
[1,000 - 5,000] [1,000 - 5,000m3] [trade effluent] [metered]	rc (£)	91.01	91.21	90.88
	m %	3.21%	3.21%	3.21%
[0 - 500 Business Assessed] [0 - 500m3] [water] [unmetered]	rc (£)	23.04	22.94	22.94
	m %	2.88%	2.88%	2.88%
[500 - 1,000 Business Assessed] [500 - 1,000m3] [water] [unmetered]	rc (£)	47.97	48.90	48.00
	m %	2.85%	2.85%	2.85%
[1,000 - 5,000 Business Assessed] [1,000 - 5,000m3] [water] [unmetered]	rc (£)	61.47	62.58	61.64
	m %	2.65%	2.65%	2.65%
[0 - 500 Business Assessed] [0 - 500m3] [sewerage] [unmetered]	rc (£)	30.75	30.54	30.81
	m %	3.15%	3.15%	3.15%
	rc (£)	70.90	71.08	70.57

[500 - 1,000 Business Assessed] [500 - 1,000m ³] [sewerage] [unmetered]	m %	3.10%	3.10%	3.10%
[1,000 - 5,000 Business Assessed] [1,000 - 5,000m ³] [sewerage] [unmetered]	rc (£)	91.01	91.21	90.88
	m %	2.89%	2.89%	2.89%
[Unmeasured RV + Fixed] [N/A] [water] [unmetered]	rc (£)	22.77	22.66	22.67
	m %	2.50%	2.50%	2.50%
[Unmeasured RV + Fixed] [N/A] [sewerage] [unmetered]	rc (£)	30.35	30.14	30.42
	m %	2.50%	2.50%	2.50%

* Table 1 updated 15 December 2016.

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	g _m %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	g _m %	2.8%	2.8%	2.8%

A1.15 United Utilities Water Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
Water 0 to 5MI	r _c (£)	35.05	34.93	34.95
	m %	2.87%	2.85%	2.84%
Wastewater 0 to 5MI	r _c (£)	52.51	52.58	52.56
	m %	2.87%	2.85%	2.84%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	g _m %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	g _m %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	g _m %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	g _m %	2.8%	2.8%	2.8%

A1.16 Wessex Water Services Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
UM-W; Water unmetered	rc (£)	19.32	19.25	19.12
	m %	1.46%	1.45%	1.45%
UM-S; Sewerage unmetered	rc (£)	15.45	15.41	15.32
	m %	1.50%	1.54%	1.57%
M-W-0; 0-1 MI Water metered	rc (£)	22.99	22.90	22.74
	m %	3.32%	3.31%	3.30%
M-S-0; 0-1 Sewerage metered	rc (£)	17.19	17.12	17.00
	m %	3.39%	3.40%	3.41%
M-TE-0; 0-1 MI Trade Effluent metered	rc (£)	22.97	22.88	22.72
	m %	3.25%	3.27%	3.31%
M-W-1; 1-5 MI Water metered	rc (£)	46.52	46.33	46.02
	m %	2.39%	2.38%	2.37%
M-S-1; 1-5 Sewerage metered	rc (£)	40.07	39.91	39.64
	m %	2.47%	2.47%	2.48%
M-TE-1; 1-5 MI Trade Effluent metered	rc (£)	44.36	44.18	43.88
	m %	2.47%	2.48%	2.49%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	gm %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	gm %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	gm %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	gm %	2.8%	2.8%	2.8%

A1.1 Yorkshire Water Services Limited

Table 1 Business customer group 1, allowed average retail cost components and allowed net margins

Customer type	Units	2017-18	2018-19	2019-20
water unmetered	rc (£)	17.67	17.10	17.34
	m %	11.70%	11.76%	11.71%
sewerage unmetered	rc (£)	17.79	17.22	17.47
	m %	7.13%	7.09%	7.03%
Water 0 - 5 MI	rc (£)	26.85	26.10	26.38
	m %	3.54%	3.55%	3.55%
Wastewater 0 - 5 MI	rc (£)	28.93	28.16	28.48
	m %	2.95%	2.94%	2.93%
Trade Effluent 0 - 5 MI	rc (£)	23.10	22.45	22.74
	m %	2.27%	2.31%	2.35%

Table 2 Business customer group 2 and allowed gross margins

Customer type	Units	2017-18	2018-19	2019-20
Water supplies 5 to 50 MI	gm %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	gm %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	gm %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	gm %	2.8%	2.8%	2.8%

A2 Company acronyms

AFW – Affinity Water

ANH – Anglian Water

BRL – Bristol Water

DVW – Dee Valley Water

NES – Northumbrian Water

PRT – Portsmouth Water

SBW – Bournemouth Water (noting that Bournemouth Water has merged with South West Water)

SES – Sutton and East Surrey Water

SEW – South East Water

SRN – Southern Water

SSC – South Staffordshire Water (created by the merger of South Staffs and Cambridge)

SVT – Severn Trent Water

SWB – South West Water

TMS – Thames Water

NWT – United Utilities

WSH – Welsh Water / Dŵr Cymru

WSX – Wessex Water

YKY – Yorkshire Water

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Printed on 75% minimum de-inked post-consumer waste paper.
December 2016

ISBN 978-1-910739-68-34

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