

Chris Loughlin  
Chief Executive Officer  
South West Water Limited  
Peninsula House  
Rydon Lane  
Exeter  
EX2 7HR

15 December 2016

Dear Chris

### **Final determination of business retail price controls**

I enclose notice of the determination of Price Controls for Business Retail Activities by the Water Services Regulation Authority ("Ofwat"). This sets out the Price Controls in respect of your Business Retail Activities starting from April 2017. This includes retail price controls for all business customers and a supplementary cap on gross margins. We are also consulting on the detailed formula for calculating the supplementary cap this week. We will finalise the formula for the supplementary cap next week to provide early certainty to stakeholders.

You will have two months from the date on which we give you notice of the final determination to decide whether to ask us to refer the determination to the Competition and Markets Authority.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Cathryn Ross', enclosed within a thin black rectangular border.

**Cathryn Ross**

**Chief Executive**

# Notification by the Water Services Regulation Authority of its determination of Price Controls for Business Retail Activities for South West Water Limited (“the Determination”)

## Introduction

This is the Determination by the Water Services Regulation Authority (“Ofwat”) as to the Price Controls for Business Retail Activities. It is made by Ofwat in accordance with Part III of Condition B (Charges) of your Appointment as a water and sewerage undertaker and the guidance having effect as a statement issued by the Secretary of State for Environment, Food and Rural Affairs under section 2A of the Water Industry Act 1991, having had regard to all the circumstances which are relevant in light of the principles which apply by virtue of Part I of the Water Industry Act 1991, including, without limitation, any change in circumstance which has occurred since the last Periodic Review or which is to occur.

The Price Controls will apply for a period of three consecutive Charging Years starting on 1 April 2017.

You must levy charges in a way best calculated to comply with the Price Controls.

Unless the contrary intention appears, words and expressions used in this document shall have the same meaning as in the Conditions of the Appointment.

## Price Control for Business Retail Activities

For the purposes of the Determination:

- “**Business Retail Activities**” means Retail Activities relating to the supply of water, the provision of sewerage services or the carrying out of trade effluent functions in relation to premises other than household premises;
- “**household premises**” has the same meaning as in section 17C of the Water Industry Act 1991; and
- “**premises**” must be interpreted in accordance with the guidance issued by the Water Services Regulation Authority under paragraph 10 of Schedule 2A and paragraph 4 of Schedule 2B to the Water Industry Act 1991.

The Price Control for Business Retail Activities:

- consists of limits on the average revenues allowed to the Appointed Business in each Charging Year in respect of the Business Retail Activities concerned for specific customer types;
- is set for a period of three consecutive Charging Years starting on 1 April 2017;
- does not impose any limit on the revenue allowed to the Appointed Business in respect of the Business Retail Activities concerned where a customer freely chooses to pay different charges to those that they would otherwise be liable for; and
- does not impose any limit on any revenue in respect of Business Retail Activities from Excluded Charges, charges (including charges for developer services) that are not Standard Charges or any miscellaneous charges that are not directly related to the supply of water, the provision of sewerage services, or the carrying out of trade effluent functions.

### **Total revenue allowed for customer group 1**

In relation to premises to which a water undertaker supplies less than 5 megalitres of water a year (“**customer group 1**”), the total revenue allowed to the Appointed Business in each Charging Year in respect of the Business Retail Activities concerned for each customer type outlined in Table 1 shall not exceed R calculated in accordance with the following formula:

$$R = [(r_c \times c_n) + w] / (1 - m) - w$$

Where:

$r_c$  = the allowed average retail cost component for a given customer type (in pounds) as set out in Table 1;

$c_n$  = the customer numbers for a given customer type;

$w$  = the wholesale revenue for a given customer type; and

$m$  = the allowed net margin for a given customer type (expressed as a percentage) as set out in Table 1.

For the purposes of this element of the Price Control for Business Retail Activities in relation to customer group 1:

- a “**customer type**” is a class of customers described in Table 1 by reference to the type of charge (known as a default tariff), fixed by or in accordance with a charges scheme under section 143 of the Water Industry Act 1991 or agreements with the persons to be charged, that is payable by them for any

water supply or sewerage services provided by the Appointee or in connection with the carrying out of the Appointee’s trade effluent functions;

- “**customer numbers**” means the average number of individual premises supplied or served by the Appointed Business in a Charging Year; and
- “**wholesale revenue**” means the revenue that the Appointee recovers in a Charging Year in respect of Wholesale Activities relating to the supply of water, the provision of sewerage services or the carrying out of trade effluent functions in relation to premises other than household premises (assuming for these purposes that the Appointee offered itself no more favourable terms in relation to payment than would be offered to any other person in respect of Wholesale Activities).

**Table 1 Business customer group 1, allowed average retail cost components and allowed net margins – South West Area**

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

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

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

## Total revenue allowed for customer group 2

In relation to premises to which a water undertaker supplies at least 5 megalitres of water a year (“**customer group 2**”), and subject to the supplementary cap below, the total revenue allowed to the Appointed Business in each Charging Year in respect of the Business Retail Activities concerned for each customer type outlined in Table 2 shall not exceed R calculated in accordance with the following formula:

$$R = g_m \times w$$

Where:

$g_m$  = the allowed gross margin for a given customer type (expressed as a percentage) as set out in Table 2; and  
 $w$  = the wholesale revenue for a given customer type.

For the purposes of this element of the Price Control for Business Retail Activities, including the supplementary cap below, in relation to customer type 2:

- a “**customer type**” is a class of customers:
  - (i) described in Table 2 by reference to the volume of water (in megalitres (“MI”)) supplied to their premises by a water undertaker, the area in which the premises are located (either the Bournemouth Area or the South West Area) and the service provided (either the supply of water or wastewater services); and
  - (ii) excluding premises where a customer freely chooses to pay different charges to those that they would otherwise be liable for.
- “**wastewater services**” means the provision of sewerage services and the carrying out of trade effluent functions; and
- “**wholesale revenue**” means the revenue that the Appointee recovers in a Charging Year in respect of Wholesale Activities relating to the supply of water or, in relation to wastewater services, the provision of sewerage services or the carrying out of trade effluent functions in relation to premises other than household premises (assuming for these purposes that the Appointee offered itself no more favourable terms in relation to payment than would be offered to any other person in respect of Wholesale Activities).

**Table 2 Business customer group 2 and allowed gross margins - South West Area**

<b>Customer type</b>	<b>Units</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>
Water supplies 5 to 50 MI	g <sub>m</sub> %	5.0%	5.0%	5.0%
Wastewater services 5 to 50 MI	g <sub>m</sub> %	5.3%	5.3%	5.3%
Water supplies 50 MI and over	g <sub>m</sub> %	3.3%	3.3%	3.3%
Wastewater services 50 MI and over	g <sub>m</sub> %	2.8%	2.8%	2.8%

**Table 2 Business customer group 2 and allowed gross margins – Bournemouth Area**

<b>Customer type</b>	<b>Units</b>	<b>2017-18</b>	<b>2018-19</b>	<b>2019-20</b>
Water supplies 5 to 50 MI	g <sub>m</sub> %	5.0%	5.0%	5.0%
Water supplies 50 MI* and over	g <sub>m</sub> %	3.3%	3.3%	3.3%

\* Water supplies 50 MI and over includes the single special agreement customer for the Bournemouth Area

### **Supplementary cap for customer group 2**

In each Charging Year, except in the circumstances set out below, the average retail revenue per customer allowed to the Appointed Business in respect of the Business Retail Activities concerned for customers within each Tariff Band in each customer type outlined in Table 2 shall not increase (compared to the average retail revenue allowed to the Appointed Business in respect of the Business Retail Activities concerned in the Prior Year for customers within each Tariff Band in that customer type) by an amount greater than an amount equal to 1% of the total revenue per customer for that customer type.

The supplementary cap does not apply to the 2017-18 Charging Year if it would prevent the Appointee from recovering the retail cost per customer (£s) and the net margin set out in worksheet R4a PR16 for that Charging Year for one or more Tariff Bands within a customer type. In that case, the Appointee may not recover more than the Retail cost per customer (£s) and the Net margin for each Tariff Band in that customer type set out in worksheet R4a PR16 for the 2017-18 Charging Year. For the purposes of this supplementary cap, “worksheet R4a PR16” means the

worksheet entitled "R4a PR16" of the NHH PR16 data tables for the Appointee that Ofwat has published with this Determination.

The supplementary cap is set out in, and must be calculated in accordance with, the Supplementary Cap worksheet.

### **Land sales**

For the purposes of the Determination Ofwat gives notice that for each of the three consecutive Charging Years starting on or after 1 April 2017:

- the value attributable to Relevant Disposals of Land allowed for in making this determination is zero; and
- variations in value received or expected to be received from Relevant Disposals of Land shall constitute a Relevant Change of Circumstance.