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22 December 2016

Dear Stakeholder

## **Final determination of business retail price controls – Supplementary Cap**

The determination of Price Controls for Business Retail Activities by the Water Services Regulation Authority (“Ofwat”) published on 15 December 2016 indicated that we intended to further consult on the detailed formula for calculating the supplementary cap.

On 16 December we consulted on the detailed formula for calculating the supplementary cap, and in particular the Supplementary Cap worksheet.

We received responses from seven water companies to the consultation. Appendix 1 sets out our response to each of the issues raised. The main changes to the supplementary cap spreadsheet are:

- Year 1 line 3, 4, 5 and 6 to refer to “R4a PR16 for all other companies” rather than “R4a PR14 for all other companies”,
- Removed reference to “actual” net margin or retail costs as actual figures will not be known at the time, and
- Referred to input source 1 and 2 on the information sheet rather than charging year 1 and 2 for consistency with the calculation sheet.

The final spreadsheet is [published here](#).

Yours sincerely

**Tim Griffiths**

**Programme Director, Water2020**

## Appendix 1: Issues raised and our response

Table 1 sets out our response to the issues raised in the consultation.

**Table 1 Response to issues raised by respondents**

Issue	Respondent	Our response
Year 1 line 3, 4, 5 and 6 should refer to “R4a PR16 for all other companies” rather than “R4a PR14 for all other companies”	Thames Water, United Utilities, Affinity Water, Northumbrian Water	We agree with this change as it will ensure that cap picks up the up to date charging information for a company where we have accepted alterations to their charges as part of PR16.
Lines 3 and 6 refer to charging guidelines – it would be helpful if Ofwat could clarify the charging guidelines that it refers to.	Thames Water	We have amended this to refer to the company forecast used to set charges in a way best calculated to comply with Price Controls.
Year 1 line 4 and 5 refer to “actual” net margin and retail cost allocation when this is the figure that companies should feed into the supplementary cap spreadsheet	Thames Water	Agree, this change is consistent with the operation of the cap.
The worksheet refers to customer type but is applied at a tariff band level	Thames Water	The supplementary cap applies to customers within each Tariff Band in each customer type in customer group 2. This is set out in the final determination.
The “information” sheet refers to charging year 1 and 2 where it would be better to refer to input source 1 and input source 2	Thames Water	Agree that this change would reduce the scope for confusion
Ofwat may wish to clarify that it is only wholesale revenue of those customers still supplied by the incumbent retailer than needs to be used in this calculation	South Staffordshire Water	Agree that it is important to clarify, it is wholesale charge for those customers that receive a retail service from the company and that have not freely chosen to pay different charges.
Is it intended that increases in wholesale revenue increase the amount that can be recovered through the supplementary cap (and vice versa)	South Staffordshire Water	The supplementary cap operates on the basis of wholesale charges per customer in the proposed charging year and so minimising the impact of changes in wholesale charges.
Could Ofwat clarify whether there is a requirement for companies to demonstrate whether the retail margin of 2.5% and allowed retail costs are being recovered	Yorkshire Water	For customers of English companies consuming at least 5MI/year of water and wastewater in England (and at least 50MI/year for customers of Welsh companies) the cap will move to a gross margin basis. The supplementary cap will help to ensure a smooth transition between the two regimes.

Issue	Respondent	Our response
The spreadsheet would be improved if it showed the value of the supplementary cap itself	Affinity Water	The spreadsheet is intended to allow companies to assess whether the cap is met. It is for companies to undertake this assessment.
We have no comments on the detailed formula but would like Ofwat to confirm the proposed spreadsheet submission timetable	Anglian Water	The spreadsheet is for companies to calculate whether they have met the supplementary cap. It is for companies to assure themselves whether they have met the cap. We will inform companies if we require them to submit completed spreadsheets at a later date.
There has been limited time to review the calculations and companies are working to extremely tight deadlines to set non household tariffs	Northumbrian Water,	We accept that the time to review the spreadsheet has been short however we consider that there has been sufficient time to review the calculations, as evidence by a number of informed responses to our consultation.
The operation of the supplementary cap is complex and is at odds with Ofwat's principle of simplifying the price controls	Northumbrian Water	We acknowledge that the calculation of the supplementary cap is reasonably complex and that is why we have provided a spreadsheet to ease understanding. We do not consider that this is at odds with the principle of simplifying controls as the introduction of the cap has allowed the move to gross margin caps by customer type which greatly simplify the retail controls.
The calculation of the cap is open to interpretation	Northumbrian Water	We have provided the calculation spreadsheet to provide greater clarity and reduce the potential scope for interpretation
The intention to calculate a supplementary cap at the tariff band level is not consistent with the introduction of the new price control categories. It should be applied at the price control level.	Northumbrian Water	The calculation of the supplementary cap at the tariff band level is consistent with the definition in the statement of method (See page 21) and is consistent with the approach that we used to assess whether company proposals would result in significant price changes for customers in our draft and final determinations. We therefore continue to consider that the supplementary cap should be applied at the tariff band level.
United Utilities proposed a reduction in the gross margin for customers using more than 5-50Ml/year from 2016-17 to 2017-18. To avoid unintended consequences, for example a reduction in charges 2017/18 which would subsequently increase in 2018/19 then United	United Utilities	As part of PR16 companies were able to propose changes to their tariffs for 2017/18. United Utilities proposed to move away from a flat 2.5% margin across all tariff bands. Consequently allowing United Utilities to base the cap on the greater of the 2016/17 and 2017/18 tariffs could lead to a

Issue	Respondent	Our response
Utilities proposed that Ofwat should set the basis for comparison for 2017/18 charges on the greater of 2016/17 (actual) and 2017/18 PR16 data tables.		significant increase in allowances. It would also increase complexity as United Utilities significantly reduced the number of its tariff bands between 2016/17 and 2017/18. We therefore continue to consider that we should base the calculation of the supplementary cap for the first year on United Utilities 2017/18 PR16 proposals.