

Charging
Ofwat
21 Bloomsbury Street
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8th January 2018

Dear Sir

Bulk Charges for NAVs: A consultation

We welcome the consultation which builds on previous guidance and makes a helpful distinction between a) large bulk supplies between incumbent water companies, and b) bulk supplies from incumbent water companies to NAVs. We think the guidance will help our business by simplifying the process of setting and agreeing charges with NAVs as we interpret it as effectively making a prescription for a NAV tariff. It would also seem to allow for a more automatic tariff adjustment process to accommodate changes in the mix of NAV customers over time, saving administrative costs.

Starting point

We agree with the proposed starting point for tariffs and as we already use our wholesale tariffs as a starting point for NAV bulk supply pricing, it should not require major changes from us.

To operate the system however, we will require each NAV to provide information to us each year about the number and mix of customers it has, along with information about the relevant volumes to use as weights in the calculation. We assume that NAVs will provide the necessary co-operation to let the system work properly.

On site ongoing costs

We agree that using a valuation of the incumbent's on site costs is a pragmatic way forward. It does seem to offer NAVs a temporary advantage in that pricing will include discounts based on the maintenance costs of mature assets, where actual NAV expenditures might be lower because new assets require less maintenance than mature ones. Perhaps this 'excess return' should be reflected in the WACC discount for on site assets, by reducing the level of that discount?

One potential drawback is that NAVs might disagree with the incumbent company's valuation of on site costs and argue that they are higher.

The WACC for on site assets

Calculations of WACC discounts could easily become over-complex and technical. It would be advantageous to all then if NAVs, incumbents and Ofwat could reach a simple markup, so we support this idea as the right approach for Ofwat to take.

As noted above, the lower ongoing maintenance costs of new assets compared to mature ones may have the effect of producing an 'excess return' to NAVs. We think the WACC discount could be adjusted to account for this.

Standardisation of charges

We agree that it would be beneficial to standardise bulk supplies rather than as today, have a series of bespoke, NAV specific and site specific charges. This will help our business by having a simpler process for setting and agreeing charges with NAVs. We note that the proposed guidelines allow flexibility for bespoke pricing for the limited number of sites that have specific and non-standard features.

Existing bulk supply agreements

We assume that the new guidelines will require the terms of existing bulk supplies be modified so that instead of paying on an agreement by agreement basis, NAVs will pay according to the starting point, as adjusted by the minus elements. We think the guidance should be clearer to say whether it applies only to new NAV bulk supplies, or whether it also applies to existing arrangements.

Provision of tariff information

It follows from the development of NAV tariffs that these be published. We anticipate that we would publish charges as soon as possible after this consultation is complete and the guidelines are finalised by Ofwat, and yearly thereafter.

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