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Dear Charging team

Consultation on bulk charges for NAVs

SSE's subsidiary SSE Water Limited (SSEW) is a new appointee or 'NAV' company in the water industry framework, providing competition to existing incumbent water companies in the provision of local water and sewerage infrastructure, mainly for developer customers.

We very much welcome Ofwat's consultation and proposals on this topic, as we have made representations over the years since SSEW was first appointed as a new entrant in the water market about concerns with this important element of the economic framework for NAV companies. In more recent times, we have focussed on the need for incumbent bulk supply charges to NAV companies to be lower than the published 'wholesale charges' they set for retailers, since NAV companies take services from incumbents at a point further upstream than retailers. As Ofwat notes in the consultation, NAV companies incur costs for supporting the "last mile" infrastructure that they provide and should, in fairness, receive a discount to the 'full' incumbent wholesale charges to enable them to cover these costs and make a margin on their activity. We therefore support Ofwat's proposals in this area, including those relating to standardisation and visibility for NAVs of the methodology that incumbents use to set bulk supply charges. These proposals should help to deliver a market environment where required information is more readily available than at present and thus, together with other reforms in the treatment of NAV companies, support the NAV market, which Ofwat has identified has not grown to the extent shown in the similar connection markets in gas and electricity.

Our responses to the consultation questions are set out in the Appendix. We would be happy to discuss these further if that would be helpful.

Yours sincerely

Aileen Boyd
Regulation Manager

Response to Consultation Questions

Q1 Do you agree with our assessment on the need for this supplementary guidance?

Yes. We consider that a clear presentation from Ofwat of how it expects incumbents to set charges for NAV companies will be very helpful to the NAV market.

Q2 Do you agree with the purpose, scope and objectives for our proposed guidance?

Yes. We very much support the need for a level playing field, as this is a basic requirement for new competitors in a market to succeed and develop. We also agree that NAV companies may require somewhat different services in different situations and should not be required to pay for services they do not request. Finally, we support the list of objectives set out on pages 18/19 of the consultation.

Q3 Do you agree with our assessment of the options and our provisional conclusion in favour of a wholesale-minus approach?

Yes. We agree with the logic and transparency of wholesale-minus pricing for bulk supplies to NAV companies, as discussed in our covering letter.

Q4 Do you agree with our considerations in terms of whose cost should be used in a wholesale-minus approach? Do you have a preference? If so, please specify the reasons for your preference.

We understand Ofwat's considerations over the cost to be removed in the wholesale minus approach and consider that some sort of benchmark would be appropriate rather than depending on the incumbent's own costs, which may be difficult to challenge. In our submission to the NAV Review project carried out by Frontier Economics, we made reference to the situation in electricity distribution, where incumbent Distribution Network Operator (DNO) charges to Independent 'DNOs' providing extension networks have evolved to provide a set percentage discount on normal wholesale network charges. While the situation is not exactly analogous to that where NAV companies provide local infrastructure water networks, we would hope that a similarly simple approach could be found to setting appropriate bulk supply charges to NAV companies. We do not believe that there is any possibility of 'cherry picking' by NAVs of sites where costs are particularly high or low, as it is developers who choose NAV companies to carry out work at particular sites in preference to incumbent water companies. Thus, it should be possible to develop a relatively simple 'rule of thumb' proxy for the cost to be removed from the starting wholesale charge, which can be used in all cases and which would be roughly right in aggregate.

Q5 Do you agree with our proposed overall approach for setting bulk charges?

Yes, we agree with the approach outlined.

Q6 Do you agree with our proposed relevant starting point?

Yes. We are particularly supportive of the unambiguous emphasis on incumbent wholesale charges forming the starting point for the calculation as we have had experience of some incumbents deciding that NAV companies should be charged a retail rate for bulk supply.

Q7 Do you agree with our definition and approach to estimate the ongoing on-site costs?

Yes. We agree that NAV companies should not be charged for on-site costs, when they are incurring these costs themselves.

Q8 Do you agree with our discussion about the WACC? In particular do you think we should adjust the incumbent water company's WACC as per the Priors Hall determination?

Q9 Do you have any practical suggestions on how to estimate the appropriate WACC?

We agree with Ofwat that there is an element of return that the incumbent company would receive if it developed infrastructure for the local development that the NAV company is serving instead and that the NAV company should not see this as an element within the bulk supply charge it has to pay. We are also supportive of the view that the effective WACC could be higher than an unadjusted incumbent water company WACC and that a simple, practical methodology for calculation would be desirable in this respect.

Q10 Are there other costs that we should take into account? If so, please specify what these costs are and why they should be considered.

We consider that it would be helpful for Ofwat's guidance to note that it is not acceptable for incumbent water companies to charge NAV companies through bulk supply charges on a basis that would not apply through their own wholesale charges if they developed the local infrastructure themselves. An example of this would be where the NAV company's demand is treated, in aggregate, as a commercial customer demand which attracts 'average daily demand charges' related to the peak demand while the constituent retail demand is all household, none of which would be charged on this basis by the incumbent at retail or wholesale level.

Q11 Do you consider that the proposed approach is sufficiently flexible to cover all current circumstances and could adapt to possible future changes?

We support Ofwat in developing a 'wholesale minus' approach and agree that this should be sufficiently flexible to cover the range of current circumstances and possible future changes. In particular, we have previously expressed the view that NAV companies may be a suitable source of demand for water trades from companies other than the immediate incumbent. Such a development would drive the need for 'transport only' bulk charges from the incumbent where water supplies are sourced from elsewhere.

Q12 Do you consider that it would be possible to standardise charges under many if not most circumstances? Can you specify the circumstances where this may not be possible?

We agree that it should be possible to standardise applicable bulk supply charges for NAV companies to a significant degree, as many NAV appointed areas fall within relatively few 'types' of housing development. We agree that it would be helpful for incumbents to develop standard types of bulk supply charges for NAVs, as they have been encouraged to do with connection charges.

Q13 Do you agree with our proposal for the provision of tariff information?

Yes. We agree that publication of bulk supply charges for NAV areas and/or the methodology of arriving at these would be very helpful for the market, for the reasons that Ofwat has highlighted in the document.