Bristol Water
Bristolwater.co.uk
0345 702 3797

It's what we're made of.

Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA
By email: NAVpolicy@ofwat.gov.uk

7 September 2020

Dear Ofwat,

Consultation on bulk charges for New Appointments and Variations (NAVs)

Thank you for inviting us to provide input on the above consultation.

Our responses to the questions in the consultation can be found overleaf. We support Ofwat's approach to ensuring consistency across bulk charges for NAVs and ensuring a level playing field for NAVs.

Please do not hesitate to let me know if you have any immediate questions or if we can be of further assistance.

Yours faithfully,

Iain McGuffog

Director of Strategy and Regulation

Q1: Do you agree with our proposed approach to weighted average tariffs?

We agree with the proposed approach to continue to define the relevant wholesale tariffs used as the starting point for NAVs bulk supply charges by setting out the menu items that would be applied to specific sites. We currently use a menu-based approach to determine our bulk supply charges for NAVs based on the typical mix of properties on a NAV site.

We note that wholesale tariffs include an element of adjustment for performance through ODIs, but that this performance for some ODIs will not normally have been directly experienced by the NAV customers, for example on supply interruptions or mains repairs. It could therefore be argued that the correct starting point would be the wholesale revenue allowance prior to any upwards or downwards adjustment for ODIs. However, in practice the impact of these adjustments is likely to be relatively small in the context of overall tariffs, and would require significant additional complexity in the calculation, so we do not propose such adjustments are required.

Q2: Do you agree that large user tariffs should not be offered for new NAV sites? What should the approach be to existing sites?

We agree that large user tariffs should not be offered for new NAV sites, in line with Ofwat's guidance for NAVs. NAV tariffs are being specifically developed to recognise the costs of serving particular sites, which may differ from those involved in serving large users, and we agree that the NAV tariffs are the most appropriate to use.

Our preference is to transition existing sites to NAV tariffs, this has occurred with the one current NAV site in our supply area. We would not force this decision on a NAV for an existing agreement as we do not believe this is in the spirit of the new guidance being introduced.

Q3: Do you agree that incumbents should use bottom-up approaches to estimate costs, or would more granular accounting segmentation be more appropriate?

We consider that bottom-up approaches to estimate costs should supplement the wholesale minus approach. Top-down approaches are consistent and transparent, whereas bottom-up approaches are less transparent but can offer some confirmation that top-down approaches are cost reflective. The larger part of incumbent tariffs are comprised of the production and bulk distribution of water and associated overheads to local areas equivalent to NAV sites, and given the operation of networks and multiple sources it would not be appropriate to attempt to calculate such costs at NAV sites on a purely bottom-up basis. Whilst maintenance activity can be used bottom up as an estimate for a site, such contracts are generally a trade off across a whole network, so is there really in practice any difference, other than illustrating that any calculation involves a wide range of assumptions and judgements.

Q4: Do you agree with CEPA's list of common avoided costs or should additional items be included? Should we incorporate this list in our guidance?

We do not fully agree with CEPAs list of common avoided costs. We set out areas where we do not fully agree in the table below. Our reasoning for this is that we incur most of these costs irrespective of whether there is a NAV site.

Activity	Bristol Water View	Reasoning
Water quality sampling	Not an avoided cost	At one of our NAV sites, we undertake the sampling and pass this information on to the NAV gratis. This is because we need to sample at the end of the network, and doing this within the NAV site is cheaper and in the common interest compared to at the boundary.
Regulatory compliance	Not an avoided cost	We have a regulatory requirement to undertake this which NAVs benefit from. We have shared our practices with NAVs at no cost to them. There is a common interest of having a shared cost. Whilst NAVs also have a regulatory compliance cost, the assumption that the incumbent saves a cost is incorrect. These are examples of arguments for a top down or hybrid rather than bottom up approach.
Leakage detection	Partially avoided	We monitor systems and notify NAVs if there is a leak on-site through the bulk meter. Manual leak detection on site is avoided, but with network monitoring these costs are de-minimis. It's also unlikely that this will be an issue for NAVs, as the sites are new and they won't have the requirement to detect leaks on site. But in the medium and long term this is the case. But as new sites have technology in built actually there is a limit to the cost avoided.

Q5: Do you agree with our proposed treatment of indirect costs?

We agree that indirect costs should be considered when estimating the common avoided costs. A top down or hybrid approach achieves this, but is not practical to implement in a bottom up approach.

Q6: Do you agree with our proposed approach to capital maintenance and replacement expenditure?

We do not agree with the proposed approach. We think the CEPA analysis was confused between depreciation and capital maintenance. We took capital maintenance costs using a top down average approach for our network, but also made an allowance for depreciation for on site costs based on the on-site value. Effectively this makes an allowance for capital maintenance of the network, and separately an annuity based on new build assumptions.

We think the suggestion about the defect period of one year for a new build asset is irrelevant – we do not see that such a short term approach would be consistent with the guidance ignoring the age of the asset. Ofwat are assuming an average asset and not judging whether new assets are more or less likely to require maintenance, leak etc, as a principal in the guidance. So we do not understand the logic of a bottom up approach here with an annuity, compared to the hybrid approach of top down for average local network maintenance and bottom up for maintenance based on a new build asset life and value, which is the approach we took as a good proxy.

Q7: Do you agree with our proposed approach to the income offset for Welsh incumbents?
No comment

Q8: Do you have other comments on the rate of return with respect to English incumbents?
Whilst we agree with the proposed approach, there is still a gap in that Ofwat provided guidance on the rate of return based on the PR14 cost of capital. As wholesale charges are now based on a PR19 cost of capital, despite our prompts Ofwat have failed to update the guidance for PR19. We think standardising this rate of return that is part of Ofwat's regulatory decisions is something that NAVs expect in order to support the effective development of the NAV market. We have included our own estimate based on the principles, but it would be easier for all market participants for Ofwat to be definitive about this.

Q9: Should our guidance explicitly state that bulk charges should not financially penalise NAVs for promoting greater water efficiency?

We agree with this principle, and suggest that at worst NAVs should be no worse off for promoting water efficiency, and indeed some level of incentivisation may be appropriate as discussed further in our response to question 10. From a practical perspective though, this is a specific measure that wholesalers can consider in delivering supply/demand balance, and potentially from NAVs "bidding in" to water resource management plans. This would be an easier route than through the NAV tariff – the approach to discounts Ofwat have chosen results in the incentive properties, and we see no easy route for adjusting the principle for water efficiency incentives other than if dealt with through the water resource planning or market. If there is a case, a specific adjustment can be agreed to the tariff, but we have not identified a practical standard approach we could justify implementing.

Q10: Do you agree with the principle that NAVs should have discounted charges if they deliver sustained lower per capita consumption (and similarly improved outcomes with respect to rainwater volumes and sustainable drainage) based on avoided costs or environmental impact mitigated?

We agree that there are clear environmental benefits from reducing water consumption, and that all water companies including NAVs should be incentivised to encourage their customers to make these reductions. NAVs are incentivised through the bulk supply charges, although this may be easier if Ofwat re-considered the controls over end NAV customer charges. We are not convinced given the NAV charging methodology that there is an easy way of discounting charges for lower pcc for the water service, other than as an agreed service that is effectively bid into a WRMP and can have a separate contractual arrangement.

Q11: Do you have other comments you wish to make regarding the methodological issues set out in CEPA's report?

Given the level of standardisation proposed in the approach to calculation of NAV tariffs, we suggest that it would be of benefit if a common calculation template was developed to show the relevant deductions from wholesale tariffs. This could be published on company websites and made available to NAVs to demonstrate the calculation of tariffs.

Q12: What are your views on how changes to bulk charges for NAVs might best be implemented?

We agree with the approach you set out. Our indicate charges for 2021/22 in October 2020 will reflect the findings as far as we see fit, and then we will consult with customers, stakeholders, developers and NAVs on this basis. We will also take into account the Ofwat findings of the review into incumbents' support for markets where it is relevant. Obviously for the indicative charges we will potentially need to reflect further on the approach and the market review findings, but this supports Ofwat's view that changing the formal published guidance is not the top priority. However, we do remain of the view that guidance on the rate of return from Ofwat is a necessary step.