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By email: NAVpolicy@ofwat.gov.uk

Dear Sirs,

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

Many thanks for the opportunity to provide feedback: we very much look forward to seeing the output in due course.

The CEPA report was hugely informative and provided insight into the current adoption and application of Ofwat's guidance, released in 2018. Since market opening, we have seen many variations in the interpretation of Ofwat's documents which have sometimes been detrimental to the objective Ofwat are aiming to achieve. This is by no means a criticism of Ofwat's documentation, but a reflection of how different businesses run, their approach to the definitions and alignment with the overall aim, which is supported by the CEPA report.

There appears a disparity between companies being keen to deliver in line with the method and in finding the most cost-effective practical solution to achieve this, resulting in a negative impact of the overall goal of ease and transparency that enables efficient transactions and promotes entrants into the NAV market. It is clear that greater clarity and stronger guidance would enhance market development and deal with many of the challenges named within the report. Having such a huge variance in application of the methodology, as found with the application to a notional NAV site, cannot solely be due to geographical variations and topography as the differentials are far greater than those experienced outside of NAV operations.

The feedback from this consultation combined with that from the 'Charging arrangements for new connection services for English companies will deliver positive rules and guidance that can only be beneficial for the NAV market's development.

1. Question 1 - 3.1.1 Weighted average tariffs

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

Yes: we can understand the 'ex-ante' modelling ease of use particularly for housing developments however this does not feel right for other types of developments and the variations that a thriving NAV market could bring.

A menu-based approach will supply much greater transparency and enable developers to fully understand the operating cost implications when considering site infrastructure. There will need to be much greater clarity to enable commercial decisions to be made with regards to assets, obligation and compliance requirements associated with the asset management. Given the regional variations and complexities of evaluating this starting point, visibility of the individual building blocks is essential.

The 'last mile' methodology applied by each Wholesaler should be available as part of the evaluation of the wholesale tariff costs. CEPA reference that wholesaler tariffs recover costs across the whole supply chain and that typically only network related costs are currently deducted; however, providing clarity in this area is likely to lead to greater innovation and more cost effective, environmentally friendly solutions.

2. Question 2 – 3.1.2 Large user tariffs

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

Large User tariffs for sites that serve anything other than a single premise or single company (i.e. factory and outbuildings) does not seem appropriate. However, it is important to consider in the context of the future market that it may be appropriate to keep this option to not stifle competition. The reason for its use from the study and feedback appears to be ease of use: if the guidance is clear and the menu is easy to navigate and assess future assessments should be no more challenging than undertaking standard business cost analysis. Transparency and clarity will be key to this being the case.

As with any changes transitioning the existing sites to the new method should be undertaken through engagement, with the ability to perhaps phase if the change incurs a significant price increase. It is likely to be better received if aligned with the financial year, with sufficient notice for budgeting purposes.

3. Question 3 - 3.2.1 Cost estimation approaches

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

The logic of the bottom up approach is sound; however, to enable NAVs to truly understand and assess costs greater transparency will be needed and this may not be sufficient in the bottom up approach. CEPA's advice was that 'drivers of the final bulk supply charges should be as transparent as possible.' We fully support this statement; this will be critical to get buy-in to this change and will also aid future development of the NAV market and eliminate level playing field concerns.

Providing greater granularity will enable applicants to assess and negotiate with the incumbent where they may feel costs are inappropriate. In this context a more granular approach feels more appropriate however this is not without challenges so perhaps the bottom up approach with clear definition and guidance of the approach and information requirements could be designed to achieve the same end goal.

4. Question 4 - 3.2.1 Cost estimation approaches

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 are not qualified to answer this question: the list seems appropriate, but this is a question that should firmly be responded to by the Wholesalers and current NAVs.

However, having a list that has been agreed should absolutely be incorporated into the guidance so NAV applicants can reference and ensure the 'wholesale minus' approach has been adhered to and is appropriate.

5. Question 5 - 3.2.2 Treatment of indirect costs

Do you agree with our proposed treatment of indirect costs?

Yes. The CEPA report references this being consistent with the LRAIC which is widely recognised and ensures consistency in approach which may go some way to alleviating the huge differential between discounts applied which will encourage prospective new entrants into the NAV market.

6. Question 6 - 3.2.3 Capital maintenance expenditure

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

We agree with the principle however would challenge whether there are no costs avoided in the first year, particularly for sites where they may have their own treatment asset. We have witnessed the challenges of new asset operations and would imagine many NAVs and the wider market have experienced similar in the primary years of operating a new infrastructure.

7. Question 7 - 3.3 Rate of return element

Do you agree with our proposed approach to the income offset for Welsh incumbents?

Yes

8. Question 8 - 3.3 Rate of return element

Do you have other comments on the rate of return with respect to English incumbents?

Only that CEPA suggested an approach that provided an additional allowance for NAVs operating efficiently, whilst we understand Ofwat not adopting this suggestion as the mechanics were inconclusive this may be something to consider in the future if the NAV market does not develop to Ofwat's satisfaction.

9. Question 9 - 3.4 Environmental impacts

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

Yes.

10. Question 10 - 3.4 Environmental impacts

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?

Yes. Any incentive to drive water efficiency should be adopted by the market: however, we do not feel this should be limited to per capita consumption. Per capita consumption is only an

effective metric in the household market and has no relevance in non-household, which already creates a challenge for water efficiency implementation across the market. There will need to be two separate metrics applied dependent upon which category the premise falls into.

The application could be similar to incentive schemes already available in the market with a pence per m3 discount applied, or the adoption of a 'green tariff' with a % discount dependent upon different elements i.e. water recycling, water efficient installations, etc

11. Question 11 - 3.4 Environmental impacts

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

The report was extremely comprehensive, and the economic logic applied produced a number of options, many of which were inconclusive. These conclusions may have been limited by the transparency of the available information as CEPA repeatedly referenced the inability to clearly define drivers and methodology utilised by the Wholesalers to reach the available values. However, the report was able to provide a clear direction and some key recommendations which have been assessed and incorporated into this consultation. The recommendation of a principles based rather than prescriptive approach feels in line with other activities in the market: however, we do need to take learnings from where this has created further challenge i.e. guidance for the Use of Temporary Vacancy flags.

For a principles-based approach to be effective this must be extremely clear in its intention and definitions and provide detail of what is included, and which methodologies/drivers are acceptable. This will not only provide prospective NAVs with clarity but enable monitoring and easy assessment of any challenges. We see any change that drives transparency and encourages competition as a positive one for the market and customers alike.

12. Question 12 - 4.5 Our proposed approach

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

Ideally this would be implemented as soon as is practically possible but is subject to the feedback from new connections and the determined complexity of the guidance required. Once the guidance is completed there should be engagement, perhaps utilising a webinar to educate all parties on the correct use of the guidance to ensure a market wide collaborative implementation.

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Yours faithfully

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