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4 September 2020

Dear Sir/Madam,

Re: Consultation on Bulk Charges for NAVs

Thank you for the opportunity to comment on the potential changes to how bulk charges for NAVs are regulated.

As outlined in the CEPA report, there is a good level of basic compliance across the sector with 'Bulk charges for NAVs: final guidance' as published in May 2018. For the previous charging year, 94% of incumbents calculated and published their NAV bulk supply tariffs and most provided a minimum of a high-level description of their charging methodology and applied the wholesale minus approach. CEPA concluded that for most areas of England and Wales, it should be possible for a prospective NAV to estimate bulk supply charges that might be applied to a site that it may compete to provide services to.

For these reasons, we believe that the most appropriate next step would be to allow time for incumbents to review the CEPA report and consider the findings, prior to considering whether any changes are necessary to the existing guidance.

Our response to your questions is set out in the appendix to this letter.

We would be happy to discuss any of our comments if required.

Yours faithfully,

[redacted]

Eleri Rees
Strategy and Regulation Director

Appendix: Response to consultation questions

Q1: Do you agree with our proposed approach to weighted average tariffs?
Yes, we believe that our methodology follows this approach as it reflects the actual mix of properties per site.

Q2: Do you agree that large user tariffs should not be offered for new NAV sites? What should the approach be to existing sites?
Yes, we believe that large user tariffs should not be offered for new sites and our methodology follows this approach as our bulk charges for new sites are calculated on a wholesale minus basis. We believe that arrangements for existing sites should remain in place for the time being but should transition to the new approach when appropriate.

Q3: Do you agree that incumbents should use bottom-up approaches to estimate costs, or would more granular accounting segmentation be more appropriate?
We believe that a top-down approach creates greater potential for competition through increased transparency and by offering operating margins that are less dependent on subjective cost allocation, which may result from a bottom-up approach. For these reasons, we consider that the benefits of a top-down approach are very important in setting bulk charges but if a meaningful, more granular approach could be introduced practically, we would be interested in working with Ofwat to bring this about. We understand that NAVs submit their Small Company Returns to Ofwat, but these are not published. In the interests of transparency, it would help all stakeholders if these returns were made available.

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 consider that the list of common avoided costs could be helpful as a checklist to improve consistency in the approach to bulk charge calculations across the industry.

Q5: Do you agree with our proposed treatment of indirect costs?
Yes, we believe that our methodology follows this approach as it includes indirect costs within the calculation of avoided costs through our top-down approach.

Q6: Do you agree with our proposed approach to capital maintenance and replacement expenditure?
Yes, we believe that our methodology follows this approach as capital maintenance costs vary over time and this is factored into our calculation of bulk charges. However, we believe that a top-down approach offers greater benefits than bottom-up in estimating costs.

Q7: Do you agree with our proposed approach to the income offset for Welsh incumbents?
Yes, we agree that it is appropriate that the rate of return remain in place under the current framework. It would be helpful for Ofwat to repeat the NAV WACC calculation for PR19 to avoid misunderstandings.

Q8: Do you have other comments on the rate of return with respect to English incumbents?
We do not have any comments on the rate of return for English companies.

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

Q9-Q10: We do not consider that there should be discounted charges as a general principle or that there is a need for changes to the guidance, however we consider that greater water efficiency should be encouraged and we welcome early discussions with NAVs to consider efficiency savings on a case-by-case basis.

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

CEPA has conducted a thorough review of the market and described incumbents' various charging methodologies. It would also have been helpful to understand whether these various approaches address potential issues, such as allowing an appropriate margin, that are otherwise being considered through material changes to the existing framework.

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

CEPA identified a good level of compliance across the sector and found that the information published by companies would be sufficient to allow a standard NAV to reasonably estimate its bulk charges. Therefore, we consider that the most appropriate course of action would be to allow companies to review the CEPA report and consider the findings. This could be reviewed to consider if further changes are required at a later date. If significant changes are to be made to the guidance, adequate time will be required for information gathering and assurance, which may not be possible in the timeframe outlined in the consultation document and suggests that any changes should come into effect for 2022/23, rather than 2021/22.