Bulk charges for new appointees – a consultation on revising our guidance: Wessex Water Response

We welcome the opportunity to respond to your draft guidance. We are supportive of many of the decisions outlined in your November conclusions document and their implementation in the draft guidance. However, we would like to reiterate some of the concerns we raised in our previous response. Specifically, around a prescriptive move to bottom up calculation of avoided costs. We put forwards in turn our thoughts on each of the key changes outlined on page 3 of your consultation below:

1. Menu based approaches

We agree that menu-based approaches accounting for the actual mix of properties to provide a starting point is the most appropriate way of setting the relevant wholesale tariff.

2. Large user tariffs

We agree that for all new appointments a wholesale minus approach should be applied and welcome the clarification that for large users the relevant starting point could be the large user tariff. We note that the leakage characteristics of a large user would differ significantly from a standard development and so additional consideration would need to be given to how it is incorporated into the final tariff.

3. Bottom-up cost estimation approaches

We still have concerns around the preference for bottom up cost estimation approaches. As we said in our previous response, moving to a bottom up approach will add complexity and uncertainty for new entrants.

Currently, once a view on the number of properties is made, a new entrant can calculate what tariffs they would pay. This gives early certainty and enables full financial assessment of the site. If a bottom up assessment of avoided costs is mandatory, a new entrant would need to understand the exact scope of assets required before they could work out a tariff. This will be significantly later in the process and result in an increase in the upfront work a new entrant is required to undertake and prolong the uncertainty of if the site is viable.

Additionally, if a full bottom up assessment of avoided costs is required, it could disincentivise innovative behaviour from new entrants. As the avoided costs will depend on what is being constructed, there would be no additional incentive to try alternative arrangements.

There are also benefits of retaining a top or middle down approach as it implicitly:

- Ensures all relevant costs are included,
- Sets allowances of average operational circumstances.

Moving away from this requires additional assumptions around the allocation of indirect costs and the whole life costs of operating and maintaining an asset.

We do see value in some flexibility here. Where a new appointment is serving a complex site or offering additional services, there may be additional avoided costs that a top down approach does not capture.

Therefore, we would suggest that less prescriptive guidance is given on calculating the avoided costs.

4. Indirect Costs

We agree that indirect costs should be included within the avoided costs. As outlined above, the benefit of a top down approach is that all of these are captured implicitly.

5. Avoided costs

We agree that consideration needs to be given to each site to ensure that any exceptional avoided costs are being captured. In the vast majority of cases, we believe that the use of a top or middle down approach does this implicitly. As mentioned above, we support less prescriptive guidance in this area.

6. Rate of return element

We agree with the conclusions that a rate of return approach is less relevant now and that any additional allowance should be based upon the operational risk transferred from the incumbent to the NAV. Under the current arrangements, using top or middle down cost avoidance, this is zero.

If this guidance were to change, and an additional allowance was to be expected, we would expect to see prescriptive guidance on what an appropriate level would be as we expect this to be an area of contention and one where a common approach would benefit all market participants.

7. Environmental outcomes

We support your stance on environmental incentives, in that these charges should not financially penalise new appointments. However, when considering some of the proposed actions to address this, care needs to be given to the interactions with infrastructure charges. Specifically, the latter two approaches considering surface water drainage and lower PCC. In both these cases, if treatment capacity exists, any reduction in costs relating to these will be reflected in the round through infrastructure charges.

8. Surface water and highway drainage

On surface water, although we agree that if the NAV constructs and operates assets relating to surface water separation then there should be some impact on their costs, we note that there are interactions with the relevant starting point and with infrastructure charges.

If a NAV (rather than a developer) is paying for the assets, then they should benefit from the lower infrastructure charges we offer but their charge to the developer should assume no surface water separation (to reflect the fact that the developer has not paid for any separation). This results in using our current infrastructure charging system to remunerate NAVs (they retain the difference between the higher infrastructure charge they collect form developers and the lower infrastructure charge they pay us) rather than including an allowance in the avoided costs.

Similarly, where we offer abated end user charges for full surface water separation and a NAV is responsible for these assets, they should charge the end user the full charge and benefit from the abated charge in the relevant starting point. Using the relevant starting point to generate a lower NAV tariff rather than including an allowance in the avoided costs.

On highway drainage we agree that the costs are incorporated in the starting point. Our highway drainage charge is set at a regional level and is not tied specifically to local circumstances. Due to this we cannot see a scenario in which a NAV could put in place systems that would result in a full abatement of this charge, therefore it cannot be treated as per our proposed approach to surface water. However, if local improvements can be made to reduce highway drainage volumes then NAVs should be able to benefit from this. This is an example of where the specific design of the site by a NAV could result in additional avoided bottom up costs based on the marginal cost of transport and treatment of the volume avoided.