

Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Yorkshire Water
Western House
Halifax Road
Bradford
West Yorkshire
BD6 2SZ

By email: NAVpolicy@ofwat.gov.uk

8 December 2020

Dear Ofwat,

Re: Bulk charges for new appointees – a consultation on revising our guidance

Thank you for the opportunity to provide feedback on your consultation on revising the guidance you provide on bulk supply or discharge charges paid by new appointees to incumbent water companies.

We have reviewed the text you have provided for the Ofwat 'Bulk charges for new appointees – guidance on our approach and expectations' publication and your decisions on a charging approach and methodology published in the accompanying conclusions from your July 2020 bulk charges consultation.

We append our feedback on the proposed text to this letter below. In our feedback we avoid excessive reference to points and observations we made to Ofwat in response to the wider consultation on bulk charges for new appointees in November 2020, and the findings of CEPA following its review of bulk supply and discharge charges set by incumbents in the market and their alignment to Ofwat's prevailing charging guidance.¹

We welcome your decision to continue to publish guidance in respect of bulk charges for new appointees, rather than develop charging rules, and see the proposed revisions as a constructive evolution of your approach from 2018.

¹ Bulk charges for NAVs: final guidance, Ofwat, May 2018

We also support the proposal for a sector-led working group on bulk charges for new appointees, and will be pleased to participate in this group as it embarks on work to promote more consistent approaches to charging by incumbent water companies and the identification and sharing of best practice.

Should you have any questions in relation to this response you can contact me by email at [REDACTED]

Yours faithfully,

[REDACTED]

Colin Fraser
Regulatory Strategy Manager

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

We welcome the shortened guidance format that retains a focus on the approach that Ofwat would use to determine bulk charges in a case where incumbents and new appointees were unable to agree the price for a bulk supply or discharge agreement. We also value the addition of text detailing the behaviours Ofwat expects of incumbents as they consider how to apply this guidance in setting and publishing their bulk charges for new appointees.

For the proposed guidance text as presented in Appendix 1 of the consultation we have the following feedback:

Proposed updates to text:

1.1.1. The new appointments and variations framework – last para, second sentence (pg. 7) *“This guidance is intended to only apply to charges under bulk supply **or discharge** agreements that incumbents make with new appointees.”*

2.2.1 The relevant starting point – first para, second sentence (pg. 12) *“In broad terms, the relevant starting point is the total incumbent’s wholesale charges that reflect the new appointee’s end customer base **for the site.**”*

2.2.1 The relevant starting point – second para, first sentence (pg. 12) – *“The bulk charges should accurately reflect the scope of **water and/or wastewater** services supplied by the new appointee on the site.”*

Observations and suggestions for inclusion:

2.2.2 Relevant avoided costs – ‘Avoided ongoing costs’ section:

- We welcome the inclusion of the statement that retail costs should not be deducted from wholesale charges. It may be helpful to aid clarity for users of the guidance to add a reference to ‘debt management’ or ‘the cost of bad debt’ in the examples of retail costs given.

- We also feel the reference in the second para to an appropriate allocation of indirect costs to be included in deductions made by incumbents could be strengthened with a reference to 'common costs' as Ofwat has done in its decisions document.
- In the fifth para, Ofwat describes how it may be appropriate for an incumbent to reflect on the impact of asset adoption arrangements in the first year after adoption. We note where the developer requisitions the assets from the incumbent and not a self-lay provider, then liabilities for certain costs may lie with the incumbent in year one. Incumbents may need to consider the level of self-lay provision in their market to reflect fairly on what costs they could reasonably be expected to avoid where a new appointee is appointed to the site.

2.4. Other relevant charges

- In respect of charges levied by incumbents upon new appointees relating to surface water entering a public sewer, we note the reference made in the guidance to drainage systems of the new appointee that may result in less surface water entering the incumbent's sewers, and how this should be recognised in the calculation of avoided costs. We consider this approach may be complex in practice and require detailed assessment on a case by case basis depending on the new appointee's specific solution deployed. We also have concerns about whether owners of private drainage systems that link into public sewers would have the benefit of similar recognition in respect of drainage charges.
- Incumbents and new appointees may also need to consider that innovative solutions such as rainwater harvesting may alleviate some surface water drainage issues and lead to identifiable avoided costs for the incumbent, but also should be considered for wastewater volumes as the typical return to sewer approach based on potable water demand may not be suitable -for example, a return to sewer allowance greater than 100% may be applicable depending on the water recycling solution used.

3.1 Applying the wholesale minus approach - Environmental incentives

- We have considered Ofwat's decision to include wording in its guidance that incumbents should consider the potential impacts on environmental outcomes, and in particular setting bulk charges that should not financially penalise new appointees for promoting greater water efficiency.

- We believe it would be very difficult for an incumbent to evidence to the affirmative the actions of the NAV in lowering per capita consumption on its site without understanding in great detail the promotional activities or physical interventions employed by the new appointee.
 - We note the guidance that avoided costs components that are not driven by the volume of water supplied should not be applied per volume of water supplied in the bulk charges calculation. We feel this could make the calculation and importantly application of bulk charges for both supply and discharge significantly more complex for many incumbents and new appointees.
 - We will assess the guidance as it is finalised and make assessments on the materiality of water efficiency sensitivities upon our avoided costs, bulk charges and expected margins for an equally efficient new appointee. We can then consider how best to apply this part of the guidance in future.
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