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By email

Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water
Business retailers
NAVs
MOSL
CCW
Other parties

21 December 2021

Dear stakeholder

Charges in 2021-22 and CMA redeterminations

I am writing to you to ask for your views on the practical and wider implications of the potential options for the implementation of the CMA redeterminations with respect to charges.

Four companies: Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water have asked the CMA for a redetermination of their price controls for the 2020-25 period. The CMA is currently undertaking the redeterminations for the four companies and expects to publish its final redeterminations in mid-February. Further details of the timetable and process can be found on the CMA's [website](#). The redeterminations will affect the wholesale and household charges of the four companies. We do not believe they will directly affect new connection charges. This letter is asking for your views on the potential implications of the implementation options.

On 17 December we received a letter (enclosed) from three of the disputing companies: Anglian Water, Northumbrian Water and Bristol Water. This letter proposed a change to Ofwat's Charging Rules to accommodate any change to the allowed revenues that the CMA may decide to implement. This change would allow the change in allowed revenues for the 2020-25 period to be recovered over the four remaining years of the price control (from April 2021), rather than three (from April 2022). We have not received a similar request from Yorkshire Water.

It is not yet clear to us that it would be appropriate to make the changes suggested by the three disputing companies. However we are considering options for the implementation of the CMA's final determinations. We have had an initial discussion with the CMA on these potential options. The CMA have not set out a preference for any option, although they

acknowledge there is a risk on timing for implementation over four years (that they may not make their redeterminations by the time set out in the companies' letter).

Options

Implementation of changes over 4 years from 1 April 2021: If the four disputing companies receive the CMA's redetermination in sufficient time they could set charges for the entire 2021-22 charging year in accordance with the price limits that the CMA sets for that year (instead of the price limits set by Ofwat in 2019). Three of the four disputing companies have suggested that this would be possible if the CMA issues its redetermination no later than the week commencing Monday, 8 February 2021 and Ofwat allows them to publish 2021-22 charges no later than Friday, 19 February 2021. We note that the CMA's published timetable refers to the publication of the final redeterminations in mid-February and so it is not certain that the option proposed by the three disputing companies is feasible within the CMA's current timetable. The three disputing companies set out the changes to the Charging Rules that they consider would be required to implement the CMA's redetermination over four years.

Implementation of changes during the 2021-22 charging year: An alternative is that charges could change during the charging year to reflect any differences in the price limits that the CMA sets for the 2021-22 charging year such that the CMA's price limits are smoothed over 3.5 years. The logical point for any change would be after six months, so that any changes applied from 1 October 2021. Statutory charges schemes must have effect "in relation to a specified period of twelve months" (section 143(1) of the Water Industry Act 1991). To continue to meet this principle, a formula for this change could potentially be set out in charges schemes and charging arrangements published before the start of the charging year to provide some certainty as to the approach. Under this option, while charges would be known at the start of the year for the first six months, there would be some uncertainty over charges for the remaining part of the year until the CMA process had concluded (which would be no later than 18 March 2021) and companies had published updated charges. We note that the three disputing companies have indicated that they could provide indicative charges within a range prior to that point.

Implementation of changes over 3 years from 1 April 2022 (default option): If both of the other options are impracticable and/or undesirable then the four disputing companies will be able to reflect any difference in the price limits that the CMA sets in charges for the 2022-23, 2023-24 and 2024-25 charging years. This option would give more time for companies to consult and engage with stakeholders on any changes to charges, and would not require any changes to Ofwat's Charging Rules. However this would provide a shorter period to smooth the impact on charges of any changes to price limits. The appendix sets out the potential charge profile of the CMA's provisional findings over three and four years. This

shows that profiling the CMA's provisional findings over three years rather than four would increase charges by around 1% extra per year, and average household charges at the end of the period by around £5, or just over 1% of the average water bill. It should be noted that there are a number of factors that impact on charges each year and can cause them to vary, for example the indexation of charges using CPIH.¹ The final impact on charges of the CMA's redeterminations will only be known when they are published and could be different to those in its provisional determinations.

Request for views

We understand the desire in principal to give effect to the CMA's redetermination as soon as possible. We are aware of the arguments the disputing companies have made to the CMA with respect to the need for any revised price limits to be implemented over a four year period.^{2,3} In summary these arguments concern:

- their ability to smooth bills over a longer time period – which would reduce the size of the bill increase required in each year and the overall size of the bill in the final year of the price control (2024-25);
- the impact on their financial resilience and the headroom they have to finance their activities^{4,5,6}; and
- their ability to undertake investment – in particular where that investment is dependent on funding which has been included in the CMA's provisional findings, for example the Essex transfer scheme for Northumbrian Water, some parts of the scope of the strategic interconnector programme for Anglian Water⁷ and some areas of other expenditure such as Anglian Water's proposal to reallocate £30 million of expenditure each year from capital to operating expenditure to ensure sufficient funding for on-going operations.⁸

¹ Further details on the impact of charges are set out in paragraphs 2.4 to 2.7 of Ofwat, [Fundamental errors of approach](#), August 2020.

² Letter from Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water to the CMA on the extension of the timetable, November 2020.

³ As set out in particular in Anglian Water, letter to Douglas cooper on proposed timetable extension, November 2020.

⁴ Anglian Water, [Response to provisional findings](#), October 2020, p. 91-96.

⁵ Northumbrian Water, [Response to provisional findings](#), October 2020, p. 71-76.

⁶ Bristol Water, [Response to provisional findings](#), October 2020, p. 57-62.

⁷ Anglian Water, [Response to provisional findings](#), October 2020, p. 33.

⁸ Anglian Water, [Response to provisional findings](#), October 2020, p. 96.

These arguments are set out in more detail in company and Ofwat submissions to the CMA.⁹ We will take these arguments into account in deciding the way forward.

The purpose of this letter is to ask for your views on the implications for customers of the three options. We think these can usefully be considered by reference to some or all of our charging principles. These principles are set out in Defra's [charging guidance](#) to us and incorporated in our charging rules, and are:

- Fairness and affordability;
- Environmental protection;
- Stability and predictability;
- Transparency and customer-focused service.

Impact on disputing companies' ability to set charges. In addition to the factors above, we need to better understand the practical implications of seeking to make the changes proposed to the Charging Rules (including whether there would need to be any related changes to the Wholesale Retail Code or any other market code). The companies have mentioned some of these issues in their letter. The disputing companies would need the necessary board assurances, companies would have to re-run financial models to generate the new charges, and update all necessary documentation before publishing their charges schemes. We are keen to understand how practical this is. For example, we are concerned about the potential increased likelihood of errors being introduced in final published charges schemes as a result of a short turnaround. We are also keen to understand the potential implications of the implementation of the CMA's redeterminations after six months of the 2021-22 charging year, how the disputing companies would propose to achieve this, and whether this is practical with their billing and customer systems. We would also be interested to understand any wider implications of such a change for example on any reconciliation mechanisms or in period adjustments.

Impact on third parties, including business retailers, NAVs, end business and residential customers and MOSL. We are also keen to understand the practical and wider implications on third parties, including business retailers, NAVs, end business and residential customers and MOSL. The attached letter indicates that the companies have already undertaken some early engagement with major business retailers and CCW over the implementation of the redetermination over four years. We are keen to understand the potential practical and wider implications of each of the options, for example in terms of the

⁹ See for example Ofwat, Fundamental errors of approach, August 2020, paragraphs 2.1 to 2.13.

ability to set onward charges, the impact on billing and customer systems as well as the impact on transparency and planning.

In parallel we are seeking Defra's views on these options.

Responses to this letter should be sent to Ofwat.Referrals2020@ofwat.gov.uk no later than close of play Wednesday 6 January 2021.

Yours sincerely

David Black
Chief Regulation Officer

Enc: Company request for issue of revised Charging Rules

Appendix 1: Potential impact on household customer bills

Table A1: Potential bill profiles of the CMA’s provisional determinations if implemented over 4 or 3 years (2017-18 prices)

	2020-21	2021-22	2022-23	2023-24	2024-25
Anglian Water					
Final determination	394	390	386	382	378
PF – 4 years	394	396	403	405	406
PF – 3 years	394	390	402	407	411
Bristol Water					
Final determination	165	162	160	157	155
PF – 4 years	165	166	166	167	168
PF – 3 years	165	162	165	168	171
Northumbrian Water					
Final determination	326	325	323	321	319
PF – 4 years	326	331	335	340	345
PF – 3 years	326	325	333	342	351
Yorkshire Water					
Final determination	379	372	364	357	349
PF – 4 years	379	379	380	381	381
PF – 3 years	379	372	377	383	389

Note: bills are in constant 2017-18 prices. Price controls are indexed to CPIH measured inflation. This would increase bills by around 2% per year, approximately equal to £8 on a £400 household bill, although this can vary depending on actual inflation.

Note: The provisional findings did not include bill adjustments to reflect Anglian Water’s proposed changes to pay as you go revenue, which would increase bills by around £8 per year if the provisional findings were implemented over 4 years and £11 per year if implemented over 3 years.

Table A2: Potential change in bills of the CMA’s provisional determinations if implemented over 4 or 3 years (change relative to CPIH inflation)

	2021-22	2022-23	2023-24	2024-25
Anglian Water				
PF – 4 years	0.3%	1.9%	0.5%	0.2%
PF – 3 years	-1.0%	2.8%	1.3%	1.0%
Change	-1.3%	0.9%	0.9%	0.8%
Bristol Water				
PF – 4 years	0.5%	0.4%	0.4%	0.4%
PF – 3 years	-1.5%	1.7%	1.7%	1.7%
Change	-2.0%	1.3%	1.3%	1.2%
Northumbrian Water				
PF – 4 years	1.4%	1.4%	1.5%	1.4%
PF – 3 years	-0.5%	2.7%	2.7%	2.5%
Change	-1.8%	1.3%	1.2%	1.1%
Yorkshire Water				
PF – 4 years	0.1%	0.1%	0.2%	0.1%
PF – 3 years	-2.0%	1.5%	1.6%	1.4%
Change	-2.1%	1.4%	1.4%	1.3%

Note: The provisional findings did not include bill adjustments to reflect Anglian Water’s proposed changes to pay as you go revenue. If implemented this would increase the average household bills for Anglian Water.