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By email

Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water

Business retailers

NAVs

MOSL

CCW

Other parties

8 January 2021

Dear stakeholder

Charges in 2021-22 and CMA redeterminations

This letter sets out our view on the appropriate approach to making adjustments to normal charging arrangements to support the implementation of the CMA redeterminations for the four disputing companies. We are setting this out now to facilitate company statements on significant changes in charges which are due to be published on 11 January 2021 and wholesale charges which are due to be published on 13 January 2021.

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. Following a [request](#) from three of the disputing companies for amendments to the charging rules to allow implementation of the CMA's redetermination, my [letter](#) of 21 December 2020 consulted on the practical consequences and impact of making an accommodation under our normal charging rules with respect to three options for the implementation of the CMA's redetermination:

Implementation of changes over 4 years from 1 April 2021, which three of the four disputing companies (Anglian Water, Bristol Water and Northumbrian Water) suggested would be possible if the CMA issued its redetermination no later than the week commencing Monday, 8 February 2021 and Ofwat allowed them to publish 2021-22 charges no later than Friday, 19 February 2021.

Implementation of changes during the 2021-22 charging year, which would allow charges to change during the charging year (potentially after six months) to reflect any differences in the price limits that the CMA sets such that the CMA's price limits are smoothed over 3.5 years.

Implementation of changes over 3 years from 1 April 2022 (default option), such that if both 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.

In addition to exploring practical considerations, we requested views on the implications for customers, which could usefully be considered by reference to the principles for charges of: fairness and affordability; environmental protection; stability and predictability; and transparency and customer-focused service.¹

We are grateful for the eleven responses we received to the consultation, which cover a broad cross section of the impacted stakeholders:

- one from each of the disputing companies (Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water);
- Affinity Water - who undertakes some billing on behalf of Anglian Water;
- Wave - the main business retailer for Anglian Water and Northumbrian Water;
- Business Stream (the main business retailer for Yorkshire Water);
- Everflow – a retailer that operates across England;
- Pennon Water services – a retailer that operates across England;
- Independent Water Networks – a small water company (NAV) that operates sites within disputing companies' areas and whose own charges are limited by reference to the charges set by the disputing companies; and
- the Consumer Council for Water (CCW).

We have also discussed the proposed approach with the Competition and Markets Authority.

Implementation over four years

Only Bristol Water and Anglian Water continue to prefer implementation over four years. Bristol Water consider that the Charging Rules should be amended to retain the option to implement over four years if the CMA can make its decision by 12 February. Anglian Water states that it could implement over four years if the CMA made its decision by 21 February, and it was allowed to publish its charges by 1 March. Both companies state that implementation over four years is important for financeability and customers as it would allow bill impacts to be spread over a longer period of time. Anglian Water also suggests that

¹ These principles are set out in Defra's [charging guidance](#) to us and incorporated in our charging rules.

implementation over four years is required to enable expenditure to reduce leakage and increase smart metering as well as to invest in its interconnector programme.

Both Northumbrian Water and Yorkshire Water propose to implement over three years. Northumbrian Water consider that implementation over four years is not now feasible for the company as it would require a decision by early in the week commencing 8 February and this is unlikely to be feasible given the scope and timing of the additional consultation being undertaken by the CMA. Yorkshire Water state that, given the current economic situation and the importance of cost certainty for customers and business retailers and that it is not likely to have a final decision by the CMA before mid-February, it would implement the decision over three rather than four years.

We recognise the desire in principle to implement the CMA's redetermination as soon as possible. We also recognise that implementing the redetermination over a longer period of time could smooth bills (if charges increase), although the impact on the basis of the CMA's provisional findings is small and likely to be outweighed by other factors affecting annual bill levels. However, having considered the issues carefully in light of consultation responses **implementing the CMA redetermination over four years appears increasingly impractical. Ultimately, in light of the views expressed, including the CMA's position on timing, we do not consider that revising the Charging Rules to allow for this possibility is in the best interests of customers.**

We do not consider that the approaches proposed by Bristol Water or Anglian Water are practical. Bristol Water's proposal to publish charges on 19 February requires the CMA to make decisions by 12 February.² However this appears increasingly unlikely. In response to a request from Northumbrian Water in December on whether it would be possible for the decision to be made on 8 February, the CMA stated that "The CMA is targeting mid-February and hence had never envisaged a date in the first third of the month. At this stage we are hesitant to indicate even the likely week – and would highlight again that numerous factors place the uncertainty very much towards slippage rather than landing early". Since then the risks to the timetable extending have increased with the introduction of a national lockdown exacerbating the difficulties the ongoing Covid-19 pandemic has created for all parties involved in the references.

While Anglian Water's proposal provides the CMA with more time to makes its redetermination (until 21 February), its proposal to publish charges on 1 March conflicts with the needs of its main retailer, Wave, who states that it requires wholesale charges by 19 February to allow it to publish business retail charges for 2021-22, and that even this timeline has significant risk. The three disputing companies' 17 December letter indicated that they

² The CMA's timetable is set out on its [website](#).

would require a CMA redetermination in the week commencing 8 February to issue (wholesale, household and new connection) charges by 19 February. Everflow states that the condensed time period required to implement changes in charges for 2021-22 would increase the risk of errors and that customers would not have sufficient notice to prepare for changes in prices that may have a negative impact on them. Pennon Water Services states that even knowing wholesale charges by 19 February would be too late for it to calculate its unmeasured household bills in a timely manner. Independent Water Networks (IWNL), a NAV that operates sites within disputing companies' areas, suggests that even if it received wholesale charges on 19 February it would only be able to publish its charges on 15 March. Consequently if IWNL did not receive Anglian Water's charges until 1 March, it appears unlikely to us that IWNL would be able to publish charges for its customers much before the start of the charging year.

We note the differences of view between the four disputing companies as to what is practicable. The impact of the national lockdown is only likely to exacerbate the difficulties faced by all parties in finalising charges for customers and providing the necessary assurance. Given the views and practical implications for business retailers who operate in the areas of all four disputing companies, it does not seem appropriate or practical to adopt different approaches for different companies.

Even if the CMA's final determinations provide additional funding, the disputing companies are aware that we do not consider that this would require changes to total revenue allowances to be implemented over four years. On financial resilience, the assessment of financeability is focused on the five year impact and this is not impacted by the timings of changes in charges. The impact on financial ratios in any one year is relatively modest in scale, and so does not provide a compelling reason to adjust the profile of charges.

We also do not consider that spreading revenues over four years rather than three is required to fund additional investment if, overall, an allowance for that investment is made. Normally within a price control period, the bill profile is unrelated to the totex profile, and reflects customer preferences for smooth bills. Consequently there is always a movement of revenue between years that is compensated by a time value of money adjustment. Consequently if the CMA provides additional funding, then this would be reflected in the overall revenue allowance for the period, and so the company will know it will be compensated at some stage for the additional expenditure, as it is with any other expenditure. Consequently there is no need for the company to delay expenditure until there is an increase in customer bills.

Overall, therefore, we do not consider that changing the charging rules to permit delaying the publication of charges under this option would be in customers' interests. It would run counter to the principles underpinning the charging regime in terms of transparency and the stability and predictability of charges. At this point in particular, as we are all impacted by a full national lockdown with its attendant uncertainties, allowing the introduction of a late increase in charges for the 2021-22 period is also unlikely to be welcomed by customers who

may already be struggling with immediate affordability issues due to the economic impacts of Covid-19 (as highlighted by Business Stream).

Implementation during the 2021-22 charging period (or over 3.5 years)

Implementation during the 2021-22 charging period, for example after a period of six months, was not supported by any of the disputing companies and most of the other respondents.

The key concerns raised by stakeholders are:

- It would require companies to reissue bills and recalculate direct debits, increasing billing and IT costs and increasing the likelihood of delayed payments and bad debt;
- It would not be consistent with Defra's charging principles, as it would increase uncertainty and reduce transparency and bill stability for customers as bills would be changing twice in a year;
- It would make financial planning difficult for business customers, and could be especially problematic for small businesses struggling to cope with the COVID situation, many of whom are already on repayment plans; and
- It may not be practical as it was not possible to consult with third parties who bill on companies' behalf, who may not be willing or able to implement changes in charges mid-year.

While a mid-year change in charges might allow faster implementation of the CMA redetermination and smoother bills than waiting until 2022-23 charges, we note the level of concern expressed over the potential practical and customer impacts of this option. In particular we note the concerns that mid-year implementation may require changes to company billing and IT systems and the potential impact on third parties who undertake billing on companies' behalf which are currently unknown. We also note concerns over the impact on customers who may not be expecting a mid-year change in bills, particularly those that might already be struggling with bills due to the impact of Covid-19. **Given the concerns raised by disputing companies and other parties, we do not support this option.**

Implementation of the CMA's provisional findings in 2021-22

CCW suggested an alternative option in that Ofwat should allow companies to reflect the CMA provisional findings in charges for 2021-22. We do not consider that this option is possible. Condition B of the disputing companies' appointments (licences) says that the 2021-22 price limits continue to apply until the CMA makes its redetermination. We do not consider that amending licence conditions to provide for implementing the CMA's provisional findings would be in customers' interests. Those findings were provisional and could change, potentially significantly, following the additional consultations undertaken by the CMA. Given their provisional nature, there is also uncertainty over precisely what they include, for

example as full financial modelling was not undertaken and the provisional findings did not include a proposed bill profile. There is also a substantial risk that any increase in charges in 2021-22 would be out of line with the bill profile from any redetermination, increasing rather than reducing bill variability. **We therefore do not consider that this option is feasible or desirable.**

Implementation over three years

Given the concerns raised by the disputing companies and other stakeholders, **we consider that implementation over three years would represent the best option in the circumstances.** This would not require changes to billing and IT systems and could be easily implemented by companies. While customer bills might increase more quickly, we expect any changes in charges to be relatively small, and the increased time would allow appropriate consultation and transparency with customers and other stakeholders, increasing predictability and stability.

We would like to reiterate our thanks to those who responded to this consultation within such a short time period.

Yours sincerely

David Black
Chief Regulation Officer

Cc Competition and Markets Authority