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Strategy & Regulation

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Dear Alex,

Bulk charges for NAVs

We would like to thank Anglian for their thorough and accessible consultation on Bulk Charges for NAVs. The consultation document structure was easy to follow with worked examples to aid understanding presented throughout.

Broadly speaking, we agree with Anglian's interpretation of the Ofwat guidance as it would apply to NAVs. This includes the application of the guidance to 'legacy' NAVs (in existence pre 1 April 2018), those appointed during the interim 1 April 2018 to 31 March 2020, and future NAV areas from 1 April 2020.

We largely support Anglian's proposed approach to calculating NAV tariffs as outlined in the consultation document, subject to the points raised in Appendix 1, which provides our response to the consultation questions.

Yours faithfully,

H. Marshall

Heather Marshall

Economic Regulation Manager

Appendix 1 – Response to consultation questions

Responses to individual questions

Q1. Do you agree with our proposed objectives and principles for the development of our NAV tariffs? If not, please explain what alternatives you think we should consider.

R1: Yes, we agree with your proposed objectives and principles.

Q2. Do you agree that we should publish the elements necessary to enable each NAV to calculate the weighted average wholesale tariff for each site, rather than a single generic price? If not, please explain what alternative you would prefer and why.

R2: We consider that both approaches, whether a calculation or a single generic price, have pros and cons and either approach could be used provided that whichever approach is selected is accessible and transparent. We will be interested to understand the views of NAVs and whether they have a preference. In terms of adhering to the charging principles around stability, predictability and fairness, there are pros and cons under both approaches which warrant consideration. For example, a site specific tariff may better demonstrate fairness in its specific application to the characteristics of a particular site, although charges may also be less predictable.

Q3. Is it reasonable to ask NAVs to provide certain information to support both the implementation of the tariff during the applicable charging year and the retrospective "true-up"? If not, please give reasons, and provide any alternative proposals if applicable.

R3: Yes, we consider it is reasonable to ask NAVs to provide the information necessary to calculate an *ex-post* true-up to the relevant wholesale tariff, although we recognise that this will increase the administrative burden for both parties. It may be possible to develop alternative arrangements that can avoid the need for an *ex-post* true-up.

Q4. Do you agree that a downward adjustment to recorded volumes should be made for charging purposes in respect of network losses between the bulk meter at the boundary of the NAV site and the end-user customers?

Q5. Do you agree with our proposed approach to making adjustments to billed volumes to reflect potential hypothetical leakage on the NAV site? If not, please set out the alternative(s) you think should be considered.

R4 & R5: We agree that an adjustment should be made to account for the cost of leakage on the 'last-mile' network owned and maintained by NAVs. This could be done either through recorded volume or through the cost adjustment.

Q6. Do you support our proposal to make a flat percentage reduction to meter readings in respect of the network losses that would have occurred had we served NAV sites? If not, please set out what alternative approach you would prefer.

Q7. If you support the flat percentage adjustment approach to address network losses, do you agree that 2.16% is a reasonable allowance? If not, what alternative figure do you propose and why?

R6 & R7: We consider an adjustment for network losses is appropriate. We question whether your calculation of 2.16% sufficiently captures the impact of new technology on leakage for new developments?

We also consider that, as an alternative, a reasonable allowance for network losses may be included in the on-site ongoing cost adjustment per property.

Q8. Have we successfully captured all of the categories of on-site cost that need to be included in the “minus” calculation, or do you consider that we have missed anything?

R8: We consider that you have captured all relevant costs. However, you may have included some costs that are not relevant to the ‘last-mile’ of network.

Q9. Do you agree that we should estimate hypothetical on-site ongoing costs with reference to the actual costs that we typically incur across our networks?

R9: Yes, we agree that using actual costs incurred as a reference is appropriate.

Q10. Do you support our proposal to use published data to derive the ongoing on-site cost element of NAV tariffs? If not, please explain why, and what alternative you would prefer.

R10: We agree that, where possible, it is best to use published data in deriving the adjustments made for NAV tariffs. However, the relevant “last mile” costs may not currently be published. We consider it to be better to use the most appropriate data rather than use less relevant data just because it is currently published.

Q11. Do you agree that the ongoing on-site cost element of the tariff should be expressed on a common per-connection basis for all NAV sites? If not, what alternative would you prefer?

R11: Yes, we believe this is an excellent approach. It is transparent, straight-forward and easily applied by NAVs. It also offers the benefit of aligning the timing with which the discount is offered to the time at which the discount becomes most relevant (i.e. as properties are connected and brought into charge).

Q12. Do you have any comments on the indicative calculations for on-site ongoing costs for 2018/19?

R12: We consider the indicative calculation to be appropriate.

Q13. Do you consider that a generic approach for capital replacement is preferable to carrying out site-by-site assessments of hypothetical future capital investment needs?

R13: Yes, we believe a generic approach is preferable. We recognise there will be differences between the capital replacement cost associated with a site that is solely flats, to a large detached property development. However, to the extent that NAVs maintain, over time, a reasonable mix of property types in their portfolio, these differences should not be material and this appears to be a sensible approach, consistent with the treatment of on-site ongoing costs.

Q14. Do you support our proposal to apply a common set of assumptions for the duration of capital replacement “holidays” so that this element of NAV tariffs can be the same for all sites?

R14: Yes, we support this proposal.

Q15. Do you agree that it is reasonable to set the replacement holiday for each type of asset at one third of the expected asset life?

R15: We agree it is appropriate to acknowledge that there is a replacement holiday however we do not understand the logic of one third of the expected asset life.

Q16. Please provide comments on our proposed methodology to give effect to the generic approach to calculating the avoided capital replacement costs, providing alternative suggestions where applicable. In particular:

a) do you agree with our identification of asset categories; is anything missing?

b) do you support our assumptions on asset lives?

c) do you have any comments on our proposed approach to unit costing and efficiency projections?

d) do you agree with our use of the NAV-specific WACC proposed by Ofwat in the Guidance for the projected return on RCV, and the wholesale WACC used by Ofwat at PR14 to convert future values into an ongoing annuity?

R16: We agree with your identification of asset categories and agree that asset lives should be consistent with the accounting asset lives. Using the Ofwat proposed NAV-specific tariff is consistent with the guidance and your principles.

Q17. Are we right to conclude that the return on RCV and depreciation components of the "minus" calculation in the methodology set out in the Guidance are only relevant for the bulk charges for NAVs appointed before 1st April 2018 so far as up-front investment is concerned (as distinct from future capital replacement)? If you have a different view, please provide details of other NAVs to which you think these elements are applicable.

R17: Yes, we agree that this is the case.

Q18. Do you agree with our proposed approach to:

a) the definition of the incremental RCV on which a return would have been earned;

b) the calculation of the income offset?

In each case, please indicate where you disagree and what alternative approach(es) you would propose.

R18: We agree with your proposed approach.

Q19. Do you agree with our analysis of the derivation of "avoided rates costs"? If not, please explain what alternative approach you think is appropriate.

R19: We consider this to be an appropriate approach**.**

Q20. What are your views on our proposed approach to the depreciation policy to be applied to the net capex that would have been added to our RCV at the time a site was developed, including the asset life assumption?

R20: We consider this to be an appropriate approach**.**

Q21. Do you have any comments on the "rolling RCV" calculations that we have set out, and the way that we propose to derive the return on capital, depreciation, and rates elements of the "minus"?

R21: The calculations seem reasonable.

Q22. What are your views on the proposal to apply a retrospective “true-up” as part of the application of NAV tariffs so that the effective price paid by the NAVs at each site is correct?

Q23. Do you agree that we should aim to set provisional tariffs that are based on the best available forecasts for the relevant Charging Year?

Q24. Do you have any comments on the proposed process for calculating provisional NAV tariffs in advance of the relevant Charging Year, and carrying out the “true-up” after the end of the Charging Year?

R22 to R24: We agree that a retrospective true-up could be applied. However, it may be possible to include arrangements that avoid the need for a retrospective true-up.

Q25. Do you have any comments on our proposed approach to dealing with future regulatory and other changes? Please indicate if there are any additional points you think we should consider.
R25: Your approach appears to be reasonable.

Q26. Do you agree that new NAV tariffs should be backdated to 8th May 2018 for existing NAVs? If not, please explain what alternative approach you propose.

R26: We consider that existing tariffs should only be adjusted if requested by a NAV.