

Dear NAV Customers,

Following questions raised by you with regards to how best we can develop a set of new tariffs for NAV bulk charges in the light of Ofwat's guidance of 8th May, we are now in a position to share our thinking with you in the form of answers to three questions that have been posed.

"When do you expect to publish your new NAV tariff?"

The guidance from Ofwat is clear, and we intend to develop NAV tariffs that are fully in line with its requirements. However, as Ofwat has indicated, the guidance leaves some scope for companies to make their own decisions on the precise methodology that they apply. For example, a tariff could involve the calculation of a weighted average price based on the mix of properties that a NAV expects to have in the relevant year, with no subsequent "true-up" to deal with variances between expectation and out-turn. Alternatively, at the other extreme, the NAV could be required to furnish us with a full account of the water supplied during the year after the end of the period to enable a retrospective re-calculation of the price to be made and charge adjustments applied accordingly.

Similarly, a calculation of the costs that we would otherwise have incurred on the operation and maintenance of the NAV supply network could be made on a site-specific basis, taking into account the actual network, topography, ground conditions and so forth at that location. Alternatively, at the other end of the scale, it could be made on a generic basis, averaged across all local networks and expressed, say, on a universal per-km or per-connection basis.

These choices generally require trade-offs to be made which involve weighing up the cost to NAVs and ourselves of acquiring and analysing additional information against the acceptance of a measure of compromise by each party at each individual site. At present we have an open mind as to the balance to be struck for each issue and we would welcome the views of all of the NAVs we serve.

Accordingly, we intend to present the issues in the form of an options paper on which we will consult in the autumn. This will set out all of the choices that we face on a full range of issues, including operating costs, leakage, RCV, depreciation, the form of tariff and the rules around its application, and so forth. We think that a six week period should be adequate for responses. We will consider the views of NAVs

carefully in arriving at our decisions on the final tariffs to be published.

As to timing, we cannot be definitive because much depends on the extent to which there is unanimity on the issues on which we intend to consult, but we would like to be in a position to publish at the turn of the year, and in any event well in advance of 1st April 2019.

As you point out, Ofwat has indicated that the guidance should be considered to have come into effect straight away, i.e from 8th May 2018. One of the questions to be addressed, therefore, is whether the tariffs, once finalised, should be backdated to that date. This will be one of the issues on which we will welcome views.

Can you confirm whether you will be using a weighted average of customers to produce a single price or a menu of costs that a NAV can apply on a site by site basis?

See above. There is a spectrum of possibilities, and we intend to set these out in the autumn consultation.

We expect the NAV tariff to be reduced for the services that we are providing on site (for example) maintenance and operating costs, billing, meter reading, leakage and emergency response. Can you confirm this?

The NAV tariff will be prepared in accordance with Ofwat's guidance. The start point will be the our wholesale tariffs, which already exclude "retail" activities such as billing and meter reading. From the wholesale tariffs we will deduct the wholesale costs that we would otherwise have incurred, comprising operating and maintenance costs (including leakage and emergency response) and the return on any capital that we would have invested, calculated at the higher rate of 4.74% stipulated by Ofwat. Any additional services that are provided by a NAV that we would not have provided ourselves would not be accounted for in the "minus" part of the tariff calculations.

I hope this is helpful and I look forward to your contribution to the consultation process.

Yours sincerely



Alex Plant
Regulation Director