

SOUTHERN WATER



Outline



- Many aspects and details to discuss

- Therefore focus on two areas:
 1. Volume based charging
 2. Charges at catchment level

- Other issues such as transient nature of resource availability, seasonality issues, etc will be left for another day

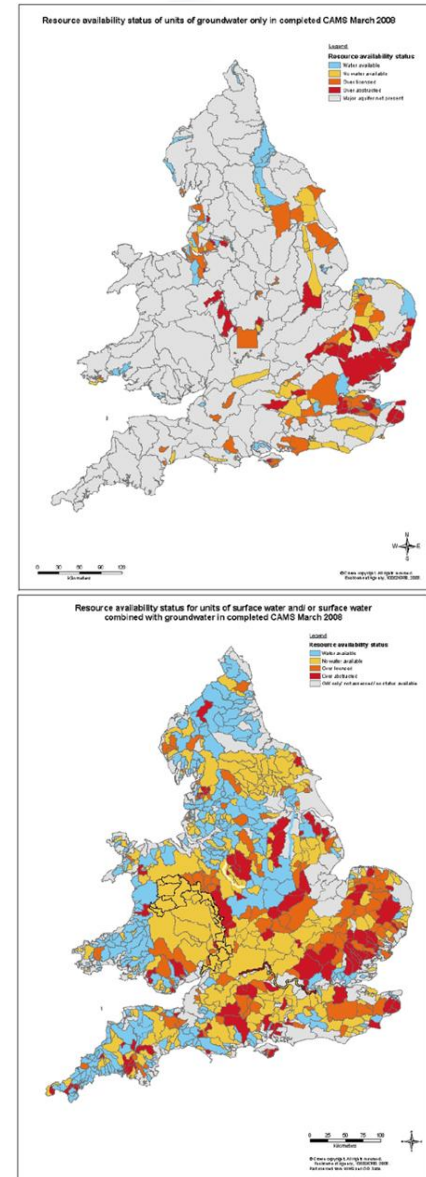
Current system



- In place from early 90's, used to recover the cost for administrating the licences
- Last FY (09/10) gross expenditure on Water Resources by the Environment Agency was £133m, income from licences was £136m
- Every abstractor has to pay an annual charge to the EA to allow them to recover their costs. The charge is formed of two components the standard charge and a compensation charge.
- both charges are based on the annual licence volume which is multiplied by some specific source factors and standard unit charges.
- Unit charges are set at a regional level of which there are 9 defined regions in England and Wales (e.g. Southern, Thames, Anglian, etc)
- Current charges try to reflect the seasonal & consumptive nature of the abstractions but they do not reflect the environment from which they are abstracted
- The charges now form a significant part of our water supply budget and yet there is no way in which these prices are incentivising the operation of the Company from a day to day perspective or strategic planning perspective
- They also have had little impact on the reduction of licence volumes, which is typically achieved through other mechanisms

Future basis for charges

- Move to volume based charges to start to influence abstraction regimes
- Opens up the issues around tariffs and incentives, but more importantly the charges are proportioned fairly across the users in the catchments according to their activity levels
- Initially in moving to a charge based system the tariffs could retain the cost recovery charge principle yet spread these charges over the abstracted volume and not the licenced volume
- Alternatively slightly more sophisticated tariffs could be introduced which introduced say a rising block element
- Further advances could then also include moving the charges from a regional level to a catchment level. These local differentials will potentially trigger different operational regimes where the infra-structure exists between supply areas.
- This latter point might appear an administrative burden, but could be simplified using a simple set of rules based on CAMS assessments, designated sites, etc.



Valuing water in the future



- Establishing catchment based prices starts to define the value of the water abstracted from a particular catchment.
- Valuing water at a catchment level will also help to set prices around licence trading and it may just start to catalyse the market place
- However, once a volume based charging system is established then additional complexity could be included such that a shadow price for water is derived for each of the catchments to reflect the environment from which the water is being abstracted
- This would help companies derive their long term plans and could also be used for new licence applications in terms of a cost benefit analysis
- The key aspect here is to ensure that the shadow price element for the catchments are consistently established and are based on assessments and designations that are already part of day to day business. Eg.

SPUc = Function (scarcity, designations, current status, future environmental target, etc)

But what does the regulator say about charging by volume?



- EA position on metering: *“We believe metering is the fairest way to pay for water, provides a mechanism for managing demand for water, and with lower demand will also help reduce greenhouse gas emissions.”*
 - *That charging by volume (which required meters to be installed) is the fairest approach to charging;*
 - *That metering can incentivise more efficient use of water;*

Summary



- Move from licence volume based charging to metered charging for abstractions is the way forward
- Derive charges on a catchment basis, whether this is through a regional derived unit charge applied to catchments using different tariff structures e.g. rising block in one catchment, seasonal in another or by deriving catchment based unit charges
- Potential to have a cost recovery charge and a shadow price
- Shadow price to be a function of existing environmental assessments, designations
- Shadow price could also be set in the context of a 25 year plan, which will provide a signal to abstractors which in turn will lead to better and more efficient solutions where they are required
- Regulatory barriers will need to be over come but there is a potential opportunity to do so
- Ofwat efficiency models will have to take account of these cost differentials but at least it would be more transparent