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Dear colleagues,

NEW CONNECTIONS CHARGING – EMERGING THINKING FOR DISCUSSION

This letter is South West Water's and Bournemouth Water's response to Ofwat's discussion paper on its emerging thinking for new connections charging. We welcome the opportunity to contribute to the debate. To summarise our high-level thoughts:

- We support the ethos that companies should be responsible to adopt detailed charging systems in accordance with overall rules set by Ofwat.
- We note the emphasis in the document on standardisation. This is appropriate given the criticisms that have been made of the variability of approaches under the current charging system.
- The proposal to eliminate potential overlap between off-site reinforcement charges and infrastructure charges is welcome but we have concerns over the method that is proposed to achieve this as it detracts from the desirable aim of achieving cost-reflectivity.
- We are pleased to note that it is not currently proposed to require asset payments to be made for sewerage assets. While the economic logic in favour of parity with water supply assets is strong, this would place an unacceptable burden on the general customer base. We estimate that this could impose additional costs on South West Water of between £5m and £20m a year depending on the level of take up.
- The timescales being suggested within the document are very tight and require urgent action on companies to enable this to be delivered. It is important that the work on the framework commenced quickly to enable companies time to consult upon and deliver this change. We note that at the last Developer Services meeting at Water UK in late March Ofwat suggested that a workshop would be held to begin these discussions. We are keen to participate and urge for it to be arranged in the near future.

Our responses to the specific questions are included in Appendix 1.

We would be pleased to discuss any of the points raised in our response, and look forward to participating in the ongoing dialogue regarding the future approach to new connections charging.

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Iain Vosper', with a stylized flourish at the end.

Iain Vosper
Regulatory Director

Appendix 1 Response to Ofwat's document 'New connections charging – emerging thinking for discussion'

Question 1

Have we missed any key issues with the current framework?

We have not identified any issues that have been missed.

Consultation Question 2

Do you agree with our emerging thinking to require work that is remote from the site to be recovered through infrastructure charges only, to increase transparency?

While we agree that the current arrangements could be improved in order to avoid any perception of double charging, we do not support the proposal for reliance to be placed on infrastructure charges. These charges should remain as a "joining fee" for those connecting to the network to contribute to the costs of remote infrastructure not related to a specific development and whether calculated on a company-wide or zonal basis, they are likely to be averaged charges which do not reflect the costs of particular schemes.

Retaining the two charges would enable the costs of individual schemes to be made known to developers to act as a signal as to where development should occur and would also ensure that the "joining fee" would continue to be paid in relation to small developments which do not trigger off site work.

If off-site requisition charges were to be removed, then it might be expected that the level of infrastructure charges would rise, as suggested in paragraph 5.4.1. Our experience is that this would disproportionately affect smaller scale developers who are often not liable for off-site reinforcement charges and who may be less able to negotiate lower land prices to take into account the effect of increased infrastructure charges.

To avoid the double charging problem, we would suggest that consideration be given to netting off infrastructure charges against requisition charges.

We acknowledge the problem referred to in sub-paragraph 2 of paragraph 3.3.2 about the limitations of a system that does not allow actual costs to be calculated until completion of the works. This may be one of the reasons why Ofwat's emergent thoughts adopt a preference for a single infrastructure charge but we would suggest that the problem could also be resolved in other ways.

In water supply, a number of companies make so-called "commercial" offers to those requisitioning mains alongside offers based on the relevant deficit/DADS calculations and this fixed charging approach could be a feature of the new system. This would comply with the concept of fixed charges, as defined in the draft charging rules.

It would also be feasible for companies to quote maximum costs for the works and then charge on the basis of actual costs subject to that maximum.

Consultation Question 3

Do you agree with our emerging thinking to allow companies to develop new approaches to charging?

Yes in principle; but we are mindful of the approach taken in Ofwat's earlier consultation (November 2013) on new connections charges which stated that one of the objectives was to create "a simpler, more consistent framework that enables quick and easy agreements to be made, avoids challenges and referrals, and makes the market for providing new connections more transparent".

We support this aspiration; however it is arguably incompatible with the approach adopted in the current discussion document. For example, paragraph 2.2 of the current consultation refers to problems for developers in making comparisons between companies and we question whether, if companies do not wish to adopt a single approach to charging, the aspiration to have consistent, comparable approaches would be frustrated.

Consultation Question 4

Do you agree with our emerging thinking to promote a level playing field through increased transparency?

We support the proposals in paragraph 5.4 relating to the use of a single explanatory document and agree that it would be helpful for Ofwat to set out principles as to what each charge is expected to recover.

While companies may wish to adopt individual approaches to the way in which they publish information about their charges, given the very consistent requests from developers for increased consistency, there would be merit in Ofwat publishing a model form of charging document.

It is important that these principles are established as quickly as possible to enable the timescales being suggested to be met.

Consultation Question 5

What would be the impact of requiring wastewater asset payments?

Based on the current level of S104s being vested within the company, asset payments would equate to expenditure of c. £5m within our area.

Developers are currently offering 20% of sewers for adoption, however in our view an asset payment would drive up the amount being offered which could in turn result in an asset payment of £20m per year if the amount were to increase to 80%.

We are unclear whether this cost would be offset within the wholesale revenue control but are assuming that this is not the proposal, given the impact on other customers. If this is the case during the current AMP period imposing such payments would divert funds to this end from maintenance and enhancement work that might otherwise be done. We therefore question whether such a rebalancing of work would be in customers' interests. Looking ahead, the cost of these payments would need to be factored into future business plans and

therefore increase bill levels generally. We do not consider that it would be appropriate to increase customer bills for this purpose.

While we accept the logic of parity between water and waste water, we would suggest that while there was a clear rationale in introducing asset payments in water supply, there is no similar justification in relation to sewerage assets.

At the time when asset payments for water supply were introduced, all mains were laid by the water companies and the introduction of these payments was the means of allowing competitive provision of mains. The position in relation to sewerage is very different with the majority of sewers already being laid by developers rather than by sewerage undertakers. It is therefore not clear that there would be any competitive benefits from introducing such payments.

Finally, such a change would be incompatible with the principle that has been discussed at the Defra task and finish groups and which we expect to feature in the finalised Defra guidance, namely, that the current balance of contributions to costs by developers and bill payers should be broadly maintained.

Consultation Question 6

Do you agree with our emerging thinking regarding information provision from companies to improve transparency?

We assume that this question refers to the proposal in paragraph 3.5.2 to deal with information provision through the company monitoring framework.

We agree with the thinking and that it is important that to dispel any misconceptions that may exist about such expenditure.

Consultation Question 7

What further information should Ofwat seek to collect from companies to aid transparency of charging in relation to new connections, as well as enabling ongoing monitoring and enforcement?

It is important that the methodology for each of the charges is demonstrated to stakeholders. Supporting this could be an ongoing assurance/demonstration that this is being consistently employed. This could be by the means of regular audits undertaken by the business or by external auditors.

Consultation Question 8

Do you have any specific suggestions on the draft rules set out in appendix A1?

Appendix A1, appears to cover all the areas in question. On this basis we have not specific suggestions at present. As work is undertaken on the framework for the rules, we should though leave this open in case other things materialise during this work.

Consultation Question 9

Do you consider it to be appropriate for Ofwat to set requirements for companies to engage with their stakeholders as part of the charging rules?

The implementation of these charging arrangements will necessitate a major change, which will turn affect our developer base. Given the sometimes contentious nature of the discussions that have been taking place about this topic between companies and their stakeholders, as a company we would be keen to secure approval of or at least assent to new charging schemes from a wide range of stakeholders.

On this basis a rule would not be necessary; however an interim rule could be set to give assurance that stakeholders would have a voice during the transitional period.

Consultation Question 10

Do you consider that any additional actions will be required to ensure an effective transition?

The transition is an important part of this proposal as there will be a lot of developers already going through the process and have budgeted for work in a certain way.

Consistency of companies' transitioning to new arrangements is essential. Consideration needs to be given as to where the developer is already mid-process and the timescale. i.e. if a developer has already signed terms and conditions with a company this agreement should stand. If this does not happen then the industry as a whole risks complaints regarding differing approaches being submitted to Ofwat.

On this basis it would be useful to have standard framework for what transfers and what does not.