

New connections charging - emerging  
thinking for discussion

Southern Water's Response

21 April 2016



## **Southern Water's response to Ofwat's emerging thinking on new connections charging**

### **Overview**

We welcome the opportunity to contribute to Ofwat's emerging thinking on new connections charging.

Southern Water has experienced a significant number of disputes from developers which have been time consuming for all parties involved. These disputes have largely concerned the reasonableness of the costs for work carried out. While we endeavour to clearly explain the basis of our charges to customers, the case-specific nature of charges levied under the current rules mean they will always be open to challenge. We therefore agree that greater clarity and transparency in setting developer charges would benefit the developer community and could lead to a reduction in the number of queries faced by companies regarding how their charges have been calculated.

Greater consistency in setting charges must not come at the detriment of a loss in cost reflectivity in charges. As such we would not favour a move towards complete standardisation of charges where there are real differences in the underlying costs incurred by companies.

The proposed opportunity for companies to be able to offer more innovative charges to developers is also welcomed. Southern Water has been looking at whether there is potential to use infrastructure charges to encourage greater water efficiency in new developments and any moves that would support the introduction of more innovative charging structures such as this would be a positive step.

We have some concerns regarding the timing of proposed changes. The consultation paper proposes that the new rules should be introduced before the end of the calendar year to give companies sufficient time to take account of any changes in the amount of revenue expected to be received from new connections in setting charges for 2017-18. However, as we will need to implement system changes to support the new charges before they can be formally adopted, the current timetable leaves little time for formal consultation with our customers on the impact on charges of the charging rules. We would propose that the new charging rules could be implemented through an informal testing process in April 2017 to allow time to formally engage with customers, with a formal implementation date of October 2017.

## **Responses to consultation questions**

### **Q.1. Have we missed any key issues with the current framework?**

The consultation document provides a complete and coherent discussion of the issues faced by both parties resulting from the current framework. We have no further suggestions to add.

### **Q.2. Do you agree with our emerging thinking to require work that is remote from the site to be recovered through infrastructure charges only?**

We agree that the existing system whereby a fixed infrastructure charge, initially set at £200 per property in 1995 and annually inflated, is recovered along with a contribution to an off-site requisition charge can lead to double-counting. This does not appear logical.

Whilst far from perfect, the Anglian model, whereby the infrastructure charge and off-site requisition charge is replaced by a new zonal charge, calculated by the value of infrastructure divided by the number of new connections, is perhaps a better basis to which the sector could look to move. This substantially solves the issue of uncertainty for developers in terms of the charges to be levied, removes the first-mover disadvantage and should reduce the risk of disputes.

This approach does, however, rely on an accurate view of costs and property numbers in order to set the charge. As there are inherent difficulties in estimating these factors, the Anglian approach may mean that developers face a risk of overpaying for connections, or for developers to underpay with the resulting burden falling on the existing customer base.

We would welcome the opportunity to work with Ofwat and the rest of the industry to develop a hybrid approach which solves the issue of imperfect forecasting information.

### **Q.3. Do you agree with our emerging thinking to allow companies to develop new approaches to charging?**

Whilst we agree that a greater degree of consistency in the way in which certain charges are set would aid transparency in the market, we believe that companies should also be able to retain the ability to develop new approaches to charging where this is appropriate. This would then allow for innovative ways of solving particular problems. For example we are investigating the opportunity to offer a discount to developers to influence the uptake of water efficient solutions within new developments.

We believe that the outcome from a revised charging regime should provide an equitable balance of risk between companies and developers. It should also ensure that developers, rather than existing customers, meet the appropriate costs of infrastructure that is required solely to meet their specific development.

We believe a new charging regime will benefit a more proactive approach to development, providing surety of cost recovery along the lines of the 'second comer' approach in the electricity industry. However, a more proactive approach will incur costs that are unlikely to be recovered within the AMP. This will need to be reflected in the Periodic Review process.

**Q.4. Do you agree with our emerging thinking to create a level playing field through increased transparency?**

As set out above, we agree that increased transparency of charges and how they are set, along with a requirement for companies to publish this methodology on a dedicated page on their website has the potential to facilitate a more level playing field.

Whilst we do not believe that Ofwat should be involved in fixing charges, we agree that it would be helpful for Ofwat to set out their expectations as to what each charge is to recover through some form of guidance document.

**Q.5. What would be the impact of requiring wastewater asset payments?**

We agree with the logic of aligning the approach to charging for wastewater and water assets. However, whilst there is a rationale for asset payments in water supply (in terms of allowing competitive provision), it is not clear in relation to sewerage assets.

For Southern Water there is no significant impact arising from this proposal given the current low level of self lay in our region. This might change in the future, so greater consistency of approach seems logical.

**Q.6. Do you agree with our emerging thinking regarding information provision from companies to provide transparency?**

We agree in principle that there is a benefit to be had in companies being more transparent in how they set their charges, and that companies should set out their charging methodologies in a dedicated area on their websites.

There is merit in requiring companies to adopt fixed fees for certain services including application fees, post-construction administrative fees, construction management fees, trench inspection fees and setting these out on their website. In addition, we agree that there is value in companies adopting a common methodology that sets out how site- or zone-specific charges should be calculated, but without going so far as to prescribe at what level these charges should be set.

Further work is required to ascertain the level and of information disclosure in a way that does not restrict companies from developing innovative charging structures where this is appropriate.

**Q.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?**

We agree that companies should publish their charges, where these charges are fixed, and set out the methodology for the calculation of variable charges on a dedicated page on their website. Companies will, however, need to retain the ability to adjust certain “fixed” charges in exceptional circumstances, if costs are likely to differ substantially from the fixed charge for a particular case. Companies could also be required to set out what may constitute “exceptional circumstances”. In these cases, companies could then set out their rationale for why charges are likely to differ and agree these with developers ahead of time.

**Q.8. Do you have any specific suggestions on the draft rules set out in Appendix A1?**

From an initial review, the rules appear to go some way to addressing the concerns as regards the transparency of charging and hence lead to a reduction in the number of disputes between developers and water companies. However, further work is required to understand what changes we would need to make to our existing charging methodologies, what impact this might have on any commercial contracts we currently have in place and then discuss these proposals with our stakeholders so as to understand whether these rules can be made to work in practice.

We welcome the opportunity to be involved in further consultation on this issue.

**Q.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?**

We agree that companies should be engaging with their customers on their charges. Such consultation forms part of our ongoing business as usual procedures. We would not support a move that turns this consultation into a one-off session with developers.

We also believe it is appropriate to engage with parties such as CCWater and our Customer Advisory Panel to confirm clarity and appropriateness of Ofwat's proposed charges before the formal charging rules are adopted. We believe that there is merit in a joint Ofwat / Industry approach to engagement at a National level especially in cases where developers are nationally based.

**Q.10. Do you consider that any additional actions will be required to ensure an effective transition?**

As above, we believe that a clear cohesive joint (Ofwat/Industry) approach to any new charging regime will be required if this is to be successfully adopted.

We also believe that the rules need to have a clear implementation date so that it is clear from when they should apply. Any application processed before the implementation date which is then disputed should refer back to the previous charging rules in place at that time.

Should you have any queries regarding our response, or would like to discuss any aspect of it with us, please contact our Head of Economic Regulation, Nikki Deeley, on 01903 272336 or by email [nikki.deeley@southernwater.co.uk](mailto:nikki.deeley@southernwater.co.uk)