

21 April 2016

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Dear Sir

Consultation on Ofwat's emerging thinking on new connections charging

Thank you for the opportunity to contribute to the review of charging for new connections. We agree that the changes brought in by the Water Act 2014 provide a welcome opportunity to look in detail at the concerns different parties have with the current arrangements and find the most appropriate solutions. The Water UK led event on this topic in September last year showed the enthusiasm the sector has to make improvements for the benefit of all stakeholders.

We support the basic premise of the consultation – that responsibility for charges and the transparency of the information we provide to customers seeking a connection rests with companies. A number of the issues developers seem to have are related to this transparency and on the basis that removal of detailed rules from the Act aids transparency, we fully support it. What we need in their place is clear guidance which provides a basis on which companies can set their charges.

We do not consider your emerging thinking currently provides a basis adequate for this purpose. The rules provide limited clarity on Ofwat's policy position and what outcome we should be seeking to achieve. For example, the rules require that we do not aim to change the balance of charges between developers and ongoing customers, but we are to seek to strengthen price signals. It is not clear to us how we balance these potentially conflicting objectives and develop a charging structure that meets these rules and balances cost reflectivity, simplicity and the overall funding of network development between ongoing customers and developers. We consider further joint work between Ofwat and companies is necessary to develop these rules into a firm foundation for charging methodologies.

The approach proposed also risks creating more inconsistency between companies which we believe will add to developers' frustrations. We note that you wish the sector to lead development of standardised approaches but the proposed timetable does not allow sufficient time for the sector to do this. An autumn decision on charging rules would leave companies limited time to develop a whole new approach to charging particularly having regard to the desirable objective of strong engagement with stakeholders. You also acknowledge that this may have implications for wholesale charges but have not recognised that Ofwat's new rules require these to be published by 1 October, albeit with some flexibility to modify them again in the first week of January.

We provide more detailed comments on the questions you have raised in the Annex to this letter. As always, we would be more than happy to expand on any aspect of our response. In the first instance please get in touch with Joanna Campbell, Economic Regulation Manager (JoannaC@waterplc.com, 01737 785 692).

Yours faithfully

John Chadwick
Finance and Regulation Director

Sutton and East Surrey Water plc

Response to Specific Questions Raised in the Ofwat Consultation
on
Emerging Thinking on Charging for New Connections

Q1. Have we missed any key issues with the current framework?

We have no issues to add but comment below on two of the issues raised.

We do not consider that there is a risk of double counting. There is a perception of double counting because of the Licence requirement to charge a separate infrastructure charge - but this does not mean that a risk actually exists.

For water infrastructure, we have not encountered practices that harm competition and discourage self-lay. We are therefore not clear how you have reached the opinion that there are “unclear incentives to self-lay”.

Q2. 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?

In order to limit accusations of double charging we support having one charge for off-site work that allows for recovery of reasonable costs associated with off-site reinforcement. This in itself does not increase transparency but a requirement to publish a methodology for calculating the charge should provide this. A balance will have to be struck between a simpler methodology which produces less cost reflective charges and a more complex and site-specific approach. The rules do not provide clarity on what the appropriate balance is and we believe this is necessary to provide consistency in approaches across companies. The time and resource to develop a new methodology for off-site charging should not be underestimated. The description of the zonal model notes that it would require companies to develop suitable forecasts of the expected level of costs incurred in relation to new developments and this may take significant time (and effort).

This approach will allow companies to reflect the impact of new developments on their actual networks. This will be more cost reflective than the current approach of a fixed fee set for all companies in their Licences. We consider that there still needs to be some level of averaging across developments to increase the predictability of charges when compared with a fully site specific approach. The rules do not however require any such averaging and some companies may choose to apply site specific charges. We do believe it is in stakeholders’ interests to have fundamentally different approaches across the country and therefore urge you to strengthen the guidance.

It is currently unclear how this proposed new approach to charging for off-site works would align with the requirement to maintain the balance of charges between developers and the wider customer base. Given the stronger link between charges and the actual impact on the network this approach will lead to some connections paying more than they would have done under the current approach and some paying less. Would this variation be allowed given the requirement to maintain the balance?

We also think the draft rules fail to reflect the policy intent of this approach. The rules refer to recovery of costs in a “given charging year”. The zonal model described looks at costs beyond one-year and therefore we think it could not be applied under the draft rules.

Q3. Do you agree with our emerging thinking to allow companies to develop new approaches to charging?

We agree that responsibility to adopt a transparent approach to charging lies with companies. However, developers also want consistency. The proposed approach could lead the sector down a route that creates greater inconsistency than we have now. We therefore support a sector-wide approach being developed that then allows each company to develop their own methodology that aligns with this. We do not consider that the rules as currently drafted provide enough direction on the policy outcome sought and therefore there risks being protracted debate on how best to comply with them.

We are concerned that the timelines presented will not allow for a sector-wide approach to be developed, consulted on and adopted for April 2017.

Q4. Do you agree with our emerging thinking to promote a level playing field through increased transparency?

We agree that transparency promotes a level playing field. The consultation notes that a level playing field can be promoted through requiring equivalent charging for equivalent services. This is currently required through legislation so it is not clear what changes the rules will drive.

We discuss the requirement for information in response to question 6.

Q5. What would be the impact of requiring wastewater asset payments?

As a water-only company we do not consider it appropriate to respond to this question.

Q6. Do you agree with our emerging thinking regarding information provision from companies to improve transparency?

We agree with the proposal that there should be one customer focused document that outlines our approach to charging. We are already working with developers to improve the information we provide them. This includes producing a developers’ handbook and “welcome pack” of information that they may find useful.

This new document will be required to provide charging methodologies. In essence this moves the current methodologies from the Act to company owned documents. This is beneficial as it can be written in a more customer-friendly way. However, it should be acknowledged that charging methodologies that achieve the aim of cost reflectivity and explain how the balance of charges between different groups has been maintained will have to include a degree of complexity.

Q7. 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?

Transparency of charging should focus on the information we provide to our customers not the information we provide to Ofwat.

Q8. Do you have any specific suggestions on the draft rules set out in appendix A1?

We have made some comments in response to the other questions. In addition:

- There are a number of areas of duplication. For example, rule 8 and rule 16 are very similar.
- Rule 8 requires a statement of assurance. Who is required to sign-off this statement?
- Reference is made, for example in rule 14, to the “present balance of charges”. It is not clear that such reference is appropriate given the “present” will no longer be such in years to come.
- What is meant by a “reasonable choice of times and methods of payment” in rule 11? We are concerned that our view of reasonable times of payment may not align with those of developers and this rule will therefore drive a number of queries/complaints.
- The rules contain a number of references to what companies “may” do. This is unhelpful and confusing. Our preference is for clarity on what the desired outcomes are as we have discussed in response to the questions above.

Q9. 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 think it is appropriate to expect us to engage and note the engagement that Water UK has led on this work to date. We do not consider that a rule is required. We are also concerned that the timetable would leave limited time for meaningful engagement from individual companies.

Q10. Do you consider that any additional actions will be required to ensure an effective transition?

Our responses to the questions above make a number of suggestions on both the timelines proposed and the content of the rules that we feel will produce a more effective transition.