



New connections charging – emerging thinking

Strategy & Regulation

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Dear Sir/Madam

New connections charging – emerging thinking for discussion

We welcome Ofwat's emerging thinking and the opportunity to comment on it at this stage.

We also welcome the opportunity to develop our approach to charging for new connections to meet the guidance set by Defra. However, any new charging arrangements we introduce will need to be underpinned by detailed guidance written by us for developers to explain the new regime. This will require an appropriate period of consultation. It is important that companies have sufficient time between the charging rules being finalised and the date new charging arrangements need to be published to consult effectively. Draft charging rules are due to be consulted on during summer 2016. In our view this would not allow sufficient time for effective stakeholder engagement on new charging arrangements that would be required by December 2016 for new arrangements coming into force from April 2017.

We also consider that there needs to be further consideration on how best to transition to new charging arrangements for connections. It takes many years for a development site to move through the planning system to construction. Changing connection charges for those sites where a commitment to a developer has already been made by us may cause problems.

The draft charging rules state that "*undertakers should take reasonable steps to ensure that the present balance of charges between developers and other customers is broadly maintained*". However, this may, where there are existing cross-subsidies, be in conflict with the January 2016 Defra guidance which states that "*Charges should ensure that the distribution of costs for new*

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infrastructure between developers and current customers of water sewerage companies is fair. Cross subsidy between developers and water customers should be limited”.

There is an opportunity to link reform of charges for new connections with how developer services are addressed within the wholesale price controls at PR19. In particular, ‘investment ahead of need’ has not been fully addressed in Ofwat’s emerging thinking and we think that Ofwat’s framework should encourage companies to develop innovative incentives to address this issue. The interaction between the wholesale revenue cap, totex cost incentive mechanism and developer income do not currently, in our view, encourage companies to invest ahead of need.

Please do not hesitate to contact me if you have any questions or comments on our response. We look forward to working closely with Ofwat in supporting the further development of connection charges going forward.

Yours faithfully



Paul Morris

Pricing and Tariffs Manager

Appendix 1 – Detailed responses

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

We welcome Ofwat's emerging thinking on charging for new connections and the draft framework that underpins this.

Any new charging arrangements we introduce will need to be underpinned by detailed guidance written by us for developers to fully explain the new regime. This will require an appropriate period of consultation. It is important that companies have sufficient time between the charging rules being finalised and the date new charging arrangements need to be published to consult effectively. Draft charging rules are due to be consulted on during summer 2016. In our view this would not allow sufficient time for effective stakeholder engagement on new charging arrangements that would be required by December 2016 for new arrangements coming into force from April 2017.

We would like to see companies encouraged to develop incentives to allow 'investment ahead of need' - a long standing criticism of water companies by the developer community. As we prepare for the next price review, we are considering developing a Performance Commitment and corresponding Outcome Delivery Incentive to address this issue. It would be helpful if the final framework acknowledges this issue and encourages companies to think about developing their own incentives. Investment ahead of need will also require companies to consider how to collect an appropriate share of costs from developers as new sites connect, so as to limit any cross-subsidy from legacy customers and avoid 'first-movers' being disproportionately affected.

There is also an opportunity to link reform of charges for new connections with how developer services are addressed within the wholesale price controls at PR19. The interaction between the wholesale revenue cap, totex cost incentive mechanism and developer income do not currently, in our view, encourage companies to 'invest ahead of need'.

Ofwat's emerging thinking is currently silent on the ongoing debate as to the definition of a 'sewer' and whether this includes sustainable drainage measures. The incorporation of the cost of sustainable drainage could be a material consideration in the final framework pending the outcome of this debate.

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?

We agree that 'network reinforcement' costs, as defined in the draft charging rules, should be recovered through cost reflective infrastructure charges (potentially set using site specific cost drivers) designed by companies is appropriate and will increase transparency.

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

Yes, we agree with Ofwat's emerging thinking to allow companies to develop new approaches to charging. However, as set out in our response to Question 1, we think more

time is required to develop effective new approaches, to consult on the proposals and to develop detailed guidance for developers.

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

We agree with increased transparency in costs. However, the cost of connecting a new development is sensitive to the distance from the development to nearest connection to the legacy network and the available capacity at the point and time of connection. If companies reflect this in their charging regimes it is likely that the cost of connecting individual development sites will vary across the country and developer customers may misinterpret this to mean that a level playing field has not been achieved by the new regime.

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

We are in favour of wastewater asset payments. The main reason for this is that it makes it more attractive for developer customers to construct the necessary infrastructure required to make the connection to the sewerage network on land owned by the developer within the curtilage of the development site, which we then adopt. In our experience, developers often prefer this option to make the new connection, as they have more control over the costs and timing of the work. The impact of wastewater asset payments should therefore be more development sites progressing smoothly through the planning process and fewer disputes with water companies.

We note however that waste asset payments do not form part of the totex threshold set in FD14, and if they are to be introduced, would need to be taken into account in cost assessment models at the next price review.

Consideration also needs to be given as to whether or not asset payments would be due on sustainable drainage measures and taken into account in the final framework.

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

Yes, we want to produce clear guidance for developers underpinned by information. Only by being transparent can we work fairly with developer customers and limit any disputes.

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?

In our view the cost of any new connection to the network is a function of the distance from the development site to the nearest point of connection and the available capacity in the legacy network at the point of connection. We would therefore encourage Ofwat to collect information on this basis:

- For 'long laterals' (i.e. from the development site to the nearest point of connection on the network), companies should provide a schedule of rates from which a cost can be derived.
- In terms of available capacity (and from this the indicative cost of offsite reinforcement) we would suggest that the approach agreed is consistent with the outputs that evolve from the 21st Century Drainage Programme.

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

We comment on the following draft rules:

- (5) The definition of a 'sewer', under the Water Industry Act 1991, as referred to in the draft rules, will need to take account of any final conclusions arising from discussions in respect of sustainable drainage measures.
- (7) Further thought needs to be given about the consultation period and the intention for the new charging arrangements to be in place for the charging year 2017-18 (see our response to Q1).
- (14) The draft rules state "*undertakers should take reasonable steps to ensure that the present balance of charges between Developers and other customers is broadly maintained*". This may be in conflict with Defra charging guidance, which states that "*Charges should ensure that the distribution of costs for new infrastructure between developers and current customers of water sewerage companies is fair. Cross subsidy between developers and water customers should be limited*". The new charging arrangements developed by companies should not be unduly constrained by a requirement to maintain any existing cross subsidies.
- (39) In order to encourage companies to invest ahead of need and ensure a fair balance in charges across all developers and existing customers, it does not seem appropriate to require infrastructure charges to match costs in any given year. It would seem to be more appropriate for costs and charges to be matched over a longer time period.

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 agree that it is important to consult with stakeholders in the development of charging arrangements. However, as set out in our response to Question 1, we think more time is required to develop effective new charging arrangements, to consult with developers on the proposals and to prepare detailed guidance for developers.

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

How the new charging arrangements are applied to development sites that are already in the planning system and where a commitment on funding has been given by us to a developer, needs to be clear. Development sites can take many years to work their way through the planning system - from the acquisition of the land, to outline planning and construction on

site. Any changes to the way in which charges for new connections are made have the potential to affect the value of land and its viability for development for housing. In our view, a sensible transitional period needs to be discussed and agreed with developer customers. Options could include:

- allowing a 3 year period of grace and introducing the new charging rules in AMP7; or
- allowing companies to waive the application of new charging rules where a commitment has already been given to the developer about the cost of the connection to the network and the site is progressing through the planning system on this basis.