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Dear Alex

Re: New connections charging – Consultation

This letter sets out our comments on Ofwat’s statutory consultation on the proposed charging rules for new connections.

For many years we have recognised the importance and impact that a well-functioning charging regime has on developer customers’ confidence when engaging with the water and sewerage sector for the provision of new connections and supporting infrastructure.

Given the wider economic and social issues linked to housing supply shortages, we also remain very focussed on ensuring that we work with developers to support the delivery of much needed new homes and commercial developments across our region. The Water Act 2014 provides a once in a generation opportunity to make a step change in the clarity of charging to facilitate growth.

As a business, we have played a leading role in shaping the reform of new connections charging and we have extensively engaged with a wide range of stakeholders including Defra, Ofwat, Water UK and developer customers. This included hosting visits with Defra and Ofwat and inputting into Defra’s Task and Finish groups. Whilst noting that Defra’s detailed charging guidance for new connections will be finalised in the autumn, we are happy to provide comments on Ofwat’s proposed charging rules and licence modifications.

We fully support Ofwat’s proposed high-level structure of charges. The composition of these proposed charges replicates our proposal that we have previously shared with Ofwat, Defra and wider stakeholders. We have long been advocates of the recovery of off-site reinforcements through a single charge as well as advocating simplification of the current regime.

We support the use of infrastructure charges as the vehicle to recover these charges and welcome Ofwat’s proposed amendment to Condition C to

remove the cap on the value of charges that can be recovered through infrastructure charges.

Customer benefits

We share Ofwat's view that the proposals for revising charging arrangements for new connections have the potential to benefit both developers and the wider customer base.

In the consultation, Ofwat state that other customers will:

"benefit from companies being able to encourage developers to locate and design their developments in a way that lowers companies' costs, enabling bills to fall particularly in the long term; and benefit from companies being able to incentivise lower water consumption – reducing their costs, also benefiting the environment and improving resilience".

These considerations are central to our current thinking on both facilitating growth and developing our charging arrangements for new connections. We believe by setting zonal charges (through the "infrastructure charges" set out in the consultation) these can:

- Send appropriate price signals and incentives to developers for developing in areas with different supply demand balances; and
- Send appropriate signals for delivery of water efficient homes

In the first instance, we intend to give these signals by varying the infrastructure charge to take account of areas of water scarcity and also to reflect the extent to which the development being proposed is water efficient.

One area which warrants further thinking is the potential funding arrangements and incentives around the development of on-site solutions which drive lower water consumption and thereby reduce potential future water resources investment; for example investment in on site grey-water systems for in home uses such as toilet flushing and garden irrigation. We are keen to work with developers and Ofwat to explore this area.

There is also a question regarding the existing accounting and regulatory treatment of developer contributions received. The nature of these contributions and basic accounting principles suggest these should be offset against the totex investment costs to which they relate. Within the existing price control mechanism, there is a fundamental mismatch by treating contributions to long-term investment as revenue.

Ofwat's May Water 2020 document raised the question of how to treat Developer Services in the network plus price control and we recommend that costs and revenues be aligned.

Promoting competition by providing a level playing field

We support competition that is demonstratively beneficial to customers. We agree that charging arrangements should appropriately facilitate a level playing field. We consider that the current charging rule relating to effective competition (paragraph 21 of the proposed rules) should be simplified to state that:

"Charges should be set in such a way to accord with the principle that charges should facilitate effective competition in existing and emerging markets".

We consider this achieves the necessary objective and avoids the creation of a complex rule that references both income offset and asset payments.

The role and definition of income offset

We consider that the future role of "income offset" in relation to new connection charging arrangements needs reconsideration. The current definition of income offset (paragraph five) is not required within the proposed charging rules and could lead to confusion.

Ofwat has been clear that the balance of charges between developers and other customers should be broadly maintained. We fully support this principle and the clarity this gives to the charging arrangements for new connections.

On this basis, we consider that the charging arrangements being developed should reflect previous income offset ex-ante rather than developing charges and subsequently offsetting potential future revenue against those charges.

For example, our current thinking on charging for on-site infrastructure is that the charges should recover a fixed percentage of the total on-site costs for the development in question. This percentage will be informed by the previous percentage we recovered under the DADS regime (on average) – i.e. internalising the equivalent application of income offset in calculating the charge. This will ensure that the balance of charges is broadly maintained.

The alternative suggested in the consultation (page 30) is that companies will develop their charging arrangements and then apply income offset to these to determine the amounts due from developer customers. Whilst

companies should be free to develop their charging arrangements as they see fit, we fail to see how the retention of this component from the previous regime benefits developer customers or is consistent with the charging principles of being transparent, customer focussed and predictable.

The role and definition of fixed charges

As stated in our response to Ofwat's March paper on emerging thinking on new connection charging we think that the proposal to define "fixed charges" in the rules requires amendment. On further reflection, we consider that defining "fixed charges" in the rules is superfluous and should be removed. Our rationale being that, as drawn, the concept of fixed charges may be construed as developing charges that are not sufficiently cost-reflective.

We think that the removal of this definition would also simplify paragraph 11 of Ofwat's charges rules; which could be amended to read:

"The charging arrangements must explain how each charge has been calculated or derived".

This removes the implicit assumption that the default charges should be fixed in nature and is more consistent with Ofwat's position on allowing flexibility in charging arrangements provided these are in accordance with the charging principles and the charging arrangements clearly explain how the charge has been derived. This would also simplify paragraphs 25, 32 and 41 of the charging rules.

We also consider that paragraph 25 of Appendix 2: Proposed revised charges scheme rules should be revised to state that undertakers should set rather than fix infrastructure charges.

Publication timetable, consultation and interaction with other rules

We welcome the clarification provided in the consultation on the interaction between the requirements to publish new connection charges and the potential interaction with other charging rules (e.g. Wholesale charging rules and charging scheme rules). This clarification addresses our previous question highlighted in this consultation.

As stated previously, we are committed to developing revised new connection charges in line with Ofwat's charging rules to commence for the charging year 2017-18. We will publish these in a single document by 1 February following effective and proportionate consultation with relevant stakeholders.

We would question the benefit to developer customers of having different publication timetables for charging arrangements for Undertakers and New Appointees. We think that Ofwat should consider a single publication window for all types of companies in preparing their charges.

We support the proposed rules for ensuring clear and transparent publication in a single document, including potential worked examples and already have plans to make this a fundamental part of the design of our revised charging arrangements for new connections. We agree that any measures that seek to minimise unexpected costs for developers are beneficial to companies, developer customers and Ofwat alike.

Further comments on new connection charging rules (Q6); charges scheme rules (Q7) and proposed licence modification (Q8)

We have a number of further minor comments on the detail of the rules, which we capture in appendix one of this letter.

If you have any comments on this response please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink that reads "Jean Spencer". The signature is written in a cursive, slightly slanted style.

Jean Spencer
Regulation Director

Appendix one – detailed comments on the charging rules for new connections

Rule paragraphs	Topic	Comment
14	Publication and transparency	We consider para 14 is worth considering carefully. It provides that a developer ought to be able to work out a “reasonable estimate” of the charges if he knows the “relevant parameters” of the development. Whilst we agree with principle, it is not clear how this will be achievable for all types of infrastructure requirements.
16	Publication and transparency	It is not clear what Ofwat envisage as being a reasonable “choice of time” relating to the proposed charging arrangements.
23-30	Charges for the Requisition of Water mains and public sewers	<p>The draft rules on requisition charges (paragraphs 23 – 30) are particularly difficult to understand:</p> <ul style="list-style-type: none"> • There is a reference to “fixed charges”. Please see the comments in our main response to our views on the removal of explicit references to fixed charges • Paragraph 27 looks misleading. There are basically three types of work – (i) work on-site, which seems on the definition to equate to “Site-Specific Work”, (ii) purely consequential but necessary work, broadly falling within the draft’s “Network Reinforcement” and (iii) provision of a line of main or sewer from the network to the development i.e. off-site, which does not seem to prompt a specific term in the draft rules but appears also to fall within the definition of “Network Reinforcement”. <p>Part (a) of paragraph 27 seems to limit requisition charges to type (i) on-site work , and by implication prohibit charges for type (ii) work certainly and probably for type (iii) work too.</p> <p>We seek clarity on our reading of paragraph 27 and how this appropriately links with paragraph 28.</p>

