

New Connections charging – consultation

Albion Water Limited response – August 2016

Background

Albion Water Limited (AWL) provides water and sewerage services to 1200 customers under the New Appointment and Variation (NAV) regime. It currently has three NAVs at Knowle in Hampshire (waste water only), Rissington in Gloucestershire (waste water, water supply and recycled non-potable water) and a site under development at Five Oaks near Chigwell (waste water, water supply and recycled non-potable). It is preferred bidder for a number of other sites.

Split of costs between developers and other customers

Whilst AWL recognises that maintaining the current overall split of costs between developers and other customers is consistent with Government guidance, it is a major barrier to market entry and competition. NAVs are not in a position to have such a cross subsidy between limited (or no) existing customers and new ones. Equally NAVs are significantly less likely than incumbents to be able to finance no net income from a new development for 12 years. These factors put new entrants at a substantial financial disadvantage relative to the incumbent when negotiating with developers. The existing cross-subsidy arrangements, clearly favouring monopoly incumbents, therefore constitute a barrier to entry into this market.

AWL encourages Ofwat and the Government to reconsider this balance such that all new development is self-financing and with any cost savings that result from reduced income offsets or asset payments being shared equally, via ongoing charges, between existing customers and new customers that connect as a result of a development.

New development served by an incumbent receives a further cross subsidy in that existing customers pay for the additional water resource, water treatment and sewage treatment costs associated with the growth in demand that a new development may cause. By contrast, for a NAV that develops its own water supply or sewage treatment capacity (rather than relying on bulk supplies), the associated costs have to be borne locally by the NAV or by the developer. It is therefore to be regretted that the consultation specifically rules out incumbents charging developers for sewage treatment upgrade costs, and makes no mention of new development covering its water resources costs. These too are significant barriers to entry into this market and serve to stifle innovation.

In particular AWL is against extending the income offset post 2020 to the new infrastructure charge as this would effectively be an encouragement to developers to develop in hard to serve areas, and reduce the incentive for developers to work with new entrants who, like AWL, are able to offer more local, flexible and sustainable solutions.

Transparency

AWL welcomes the proposals for greater transparency in the charges imposed on developers. In particular the requirement to publish charges and explain why they vary from one area to another. The Bristol Water approach of identifying areas of lower and higher cost for developments is

welcomed. The variation in infrastructure charges and the transparency behind the variation will allow NAVs to focus on areas where they may be able to add most value, i.e. where the cost to serve a new development by the incumbent is greatest. This is a much better economic solution than an incumbent incurring high costs to serve a particular development and spreading the costs across its customer base.

The proposal to require NAVs to publish developer charges does not reflect the nature of NAVs. The financial relationship between the NAV and the developer is covered by a confidential contract between the two prior to the NAV company obtaining the formal appointed undertaker status from Ofwat. Additionally the appointed area of the NAV usually corresponds very closely with the area being developed therefore there is very limited scope for further development within the NAV area.

AWL is happy to work with Ofwat to define what connection charge information it is appropriate for a NAV to provide.

Charging basis between incumbents and NAVs

Whilst not covered by this consultation, to further competition in terms of providing competitive water services to developers, and customers, it is important that the charging basis between incumbents and NAVs for bulk supplies is fair, predictable and transparent, together with the new infrastructure charge, wholesale tariff, income off-sets and asset payments – including the interaction, if any, between them. In particular we support the Ofwat proposals (bottom of page 27) that companies' system of charges will provide a level playing field for NAVs and we would expect Ofwat to require companies to show, for example with worked examples, how this is the case.

Terminology

AWL would recommend that the industry takes advantage of these changes to improve its terminology in this area, in particular by avoiding the use of the term requisition. Off-site charges, on site charges, income offsets and asset payments by contrast are clear.

Consultation questions

Q1 In light of our updates and clarifications, do you agree that we still retain the key features and approach of our March proposals?

As discussed above the current cross subsidy from existing customers to new development works against competition and is a very significant barrier to entry for more efficient, sustainable and resilient solutions.

Q3 Do you agree that offsetting the infrastructure charge, rather than requisition charge, has merit? If so, when and how should this change be brought about?

No AWL strongly disagrees with this. The infrastructure charge should reflect the full cost of improvements to the offsite infrastructure. The offset should not be used to subsidise difficult to serve sites. If there has to be an offsetting process (Q1) then it should be applied equally to all new developments, perhaps on a per plot basis. To achieve this it would be necessary to split the proposed requisition charge into two. An on-site cost against which an income offset or asset

payment could be made, and a connecting pipe/sewer charge against which an income offset or asset payment could not be made.

This is summarised in the table below, developed from the diagrams on pages 20 and 30 of the consultation.

<p align="center">New framework (as per consultation – post 2020)</p>	<p align="center">AWL proposal (although ideally with no income offsets or asset payments)</p>
<p align="center">Infrastructure charges These cover all the network reinforcement works away from the development site (with income offset)</p>	<p align="center">Infrastructure charges These cover all the network reinforcement works away from the development site</p>
<p align="center">Requisition charges Costs of the physical infrastructure between the existing network to (and on) a new development</p>	<p align="center">Requisition charges – costs of pipe / sewer connecting new development site to existing network</p>
	<p align="center">Requisition charges - costs of the physical infrastructure on a new development (with income offset / asset payment)</p>
<p align="center">New connection charges Cost of connecting premises to water mains or public sewers</p>	<p align="center">New connection charges Cost of connecting premises to water mains or public sewers</p>