

Response to Ofwat consultation on new connection charging.

PDI Utilities, as a WIRS accredited Self-Lay Provider, are pleased to provide below our comments to the New Connections Charging proposals detailed within Ofwats recent consultation document.

The introduction of 'Charging Rules' for new water connections (mains and services) has potential advantages to the way developers pay for new water supplies and could also bring benefits to the competitive water connections market.

However, we have concerns that Water Companies will be allowed to set their own 'local charging arrangements'. In order to safeguard the provision of Self Lay, Ofwat would need to introduce safeguards to ensure that each individual Water Companies proposals in this regard does not adversely effect Self Lay provision and other forms of competition.

We welcome the proposal to abolish the 'current' Infrastructure charge. It has always been a concern of SLO and Developers that there is 'possibly' some degree of double charging/overlap with other water company charges, when applying the 'current' standard Infrastructure charge. Our experience is that the water companys response, when challenged, would vary from company to company, that the Infrastructure charge covers 'maintenance and repair of the network', 'reinforcement of the network' or some would offer 'provision for future expansion of the network' to justify the charge. However, in addition to applying the infrastructure charge, Water Companies still require Developers to pay separately for offsite Reinforcement. Another area for consideration in this regard should focus on charges to domestic consumers for water used. When charging consumers for the volume of water supplied, the bill includes 'daily standing charges', it is our understanding that this charge also includes an element for maintenance and repair of the service/network! It is also our understanding that the Owner/Occupier is now responsible for the service /supply from the property boundary, absolving the water company of any liability for maintenance or repair costs.

We have concerns that the 'new infrastructure Charges' would need to be sufficiently transparent and each water company should have to submit their proposed methods for calculating these charges to Ofwat, giving all stake holders the chance to comment, prior to the introduction of the 'New Connections Charging' implementation. We would expect the water companys submission to Ofwat to demonstrate how they propose to calculate the various costs, and these should include, 'future revenue from the assett', the cost of 'asset installation', the make up of the 'Income Offset', any charges relating to 'offsite reinforcement' relating to supplying the development site only, water company Non Contestable costs and how finally any 'Asset payment' due to the developer or Charge to the developer is arrived at.

1. General Observations

NB. *Our response in this section sets out some of the comments produced by FWC, which we now believe to be lodged with Ofwat, and also reflects our position as detailed below.*

In addition to the concerns outlined above we also make the following general observations on the proposed charging rules and implementation arrangements. These are in addition to our detailed feedback to the specific consultation questions given in Section 2 of this response.

1. Given the move to a 'rules' based framework for water connections charging we are concerned that the definitions proposed by Ofwat are insufficient to categorically define:-
 - a) the extent of 'site works'; and,
 - b) the limits on upstream work and where the boundary is between costs funded by 'new connection' monies and that which is the water company is responsible for under their general (WIA Section 37) duties.

To us this, especially linked to the lack of financial clarity discussed below, can only produce a situation where the new 'charging rules' are able to be interpreted differently by each water company and thereby negate a key driver for making the changes. Hence, in our detailed response, we suggest how definitions should be improved.

2. In order for Developers/SLO's to check whether they are in receipt of income offset allowances matched to that detailed in regulatory settlements. Ofwat would need to ensure that they build into the charging rules a requirement for each company to publish a figure for their total annual 'income offset' allowance and to state the estimated number of connections (i.e. those requiring mains) that this covers. Note – from a self-lay perspective we view clarification of 'income offset' allowances as being of greater importance than the other reported income and expenditure figures.
3. With self-lay provision, the way that asset payments are calculated has material impact on the viability of competitive provision. Whilst 'income offsets' are discussed by Ofwat how the associated 'cost of provision' rates should be determined is not adequately specified. We ask that this omission gets rectified before the Ofwat 'charging rules' get published.
4. We feel that the Ofwat rules should be consistent in their terminology and descriptions to that used in the 2014 legislation. In this regard we do not think that it is a helpful departure to indicate that defrayment of construction costs comes from 'existing customers' when the latest legislation (in Section 51CD[4]) provides for using 'revenue derived from the water main' (i.e. future revenue from the connected properties). So although the current, loan based, charging approach is often misconstrued by indicating that the subsidy comes from existing customers the reality is that it is savings in the cost to serve new customers (which is less than other customers who are supplied through older systems which require much higher maintenance etc.) which is being used to assist new provision funding. So, assuming that newly connected customers are supplied on the same tariff as other customers,

it is surely the resultant operating cost savings which are available to subsidise mains installation costs.

5. Other charges associated with new connection provision are encountered by developers and Self-Lay Providers, particularly at the pre-development enquiry, and advanced modelling stages. Assuming that these continue to be relevant (see below) we ask that it becomes a requirement for all new connection related charges to be included in the schedules water companies publish.
6. Historical cases brought to Ofwat by various SLO's and others, has resulted in significant improvements in clarifying what costs are permissible for water companies to recover in their new water connection charging. We are concerned that, Ofwat appear to have decided to give each company freedom to decide on their own local charging arrangements. This means that the option, favoured by ourselves, for making the Regulators decisions a mandatory requirement and leaving no room for individual company interpretation has been discounted without adequate explanation given, or the benefits/disbenefits quantified. Given that, with new rules, we can now only foresee having to go through many rounds of disputes to get the clarity on permissible charging that we regard as essential we ask Ofwat to reconsider introducing the 'mandatory requirements' option.
7. To avoid any conflict with the description of other charging schemes we suggest that 'new connection charging arrangements' be universally used. This fuller description should also facilitate focused web searches to access company specific connection related documentation.

2. Responses to the specific consultation questions posed by Ofwat

NB. *Our response in this section sets out the comments produced by FWC, which we now believe to be lodged with Ofwat, and also reflects our position as detailed below.*

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

The features in the March consultation which we regard as being watered down, or lost, are as follows:-

- a) The March proposals expressed the view that Ofwat "recognise that some degree of standardisation across the sector may be desirable in terms of providing developers with a broadly consistent experience across the country". This is not evident in the July document where the emphasis is on each water company setting their own 'charging arrangements'. We are dismayed that Ofwat is no longer interested in standardisation and fear that this will greatly disrupt the competitive water connections market.

- b) Under the company monitoring framework the March proposals said; “in relation to new connections charging, there may be a range of information that it would be beneficial for companies to provide to their stakeholders. We expect that the provision of this information will be covered by the monitoring framework. This will help ensure that such information is provided in a suitably robust and customer-focused manner”. By now we would have expected Ofwat to be able to specify the data they required reporting and are disappointed that the detail appears to be left to water companies themselves and is not specified in the draft ‘charging rules’.
- c) We do not understand the rationale not to insist on water companies following a prescribed consultation framework. Instead they can decide for themselves on who they consult with and their consultation arrangements. Having gone through 2 rounds of formal consultation with both Defra and Ofwat, covering what is primarily ‘high level’ direction, it is, to us, irrational that water companies can impose detailed charging arrangements without first having to publish draft documents and going through a formalised consultation stage prior to local implementation.
- d) We continue to be concerned that, whilst both the March and current documents call for the ‘balance of charges’ (though we would challenge the wording of ‘between developers and other customers’ and propose that it becomes ‘between developers and the subsidy from future income’) to be maintained, as there is insufficient data in the public domain for the existing position to be independently quantified. Furthermore setting the threshold as ‘retaining the balance’ means that savings (from either administrative benefits or simply more work being done through self-lay) will end up being credited back to the water company rather than being equitably shared.
- e) Reference is made in the March document to the clear delineation used in Scotland to define discrete work elements and associated funding responsibilities. This clarity has not been carried forward into the latest document so there is ambiguity about how ‘deep’ into the network recoverable ‘reinforcement works’ can go. This also applies to which parts of the network Infrastructure Charge monies can be used against. Our view is that the boundary should be set so that ‘trunk mains’ capacity is a water company responsibility with all necessary work downstream of a ‘trunk main’ connection being eligible for a developer funding contribution. This fitting well with the restriction on new connections being made to ‘trunk mains’.
- f) Further to the above Point (e) the ‘Point of Connection’, i.e. the boundary between what can be classified as site specific mains and the water company network also needs to be categorically defined. Not least because it forms the divide between works explicit to a site and, any, more general network enhancements and will, if not now specified, surely be a cause of future disputes. Court cases (admittedly against former versions of water legislation) have centred on determining the Point of

Connection on 'sound water engineering practices' which, in the context of avoiding future disputes, does not look to be sufficient. Instead we propose that Ofwat build into their charging rules a definition for this divide based on the nearest practical location where the network has a main sized at the same diameter as, or larger than, the connecting main. This has the added advantage of negating any delays at the terms issue stage whilst modelling is done.

Q2 Do you agree with our updates and clarifications to our proposed rules?

Our overall response gives our views on the latest Ofwat 'New Connections Charging' consultation document and the proposed rules contained therein.

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?

We fully support the concept of using the income offset to reduce infrastructure charge payments rather than against mains provision costs and are dismayed that, for the time being, this concept is not being promoted. To us there are many advantages, partly in the self-lay arena, of offsetting infrastructure charges as it:-

- Provides better separation between 'retail' and 'wholesale' activities; and,
- Enables Self-Lay Providers to cost work to developers independent of needing information about 'asset payment (cost of provision) allowances' or 'income offsets' (i.e. it affords significant administrative cost and levels of service benefits); and,
- Facilitates fairer competition between Self-Lay Providers and water company on-site provision as both would be (from a costing perspective) free to respond to their developer customers without needing to involve the other party; and,
- Would provide to developers and Self-Lay Providers a tangible marker that the disruption caused by introducing the new charging rules has some benefits.

It appears to us that any delay (say to 2020) would mean that introducing this concept, and the benefits it would bring to both water companies and Self-Lay Providers, would be missed. This is because the impetus from making the change now would be lost and all will become used to whatever gets put in place and not be prepared, especially at a regulatory review time, to put effort into making further changes to local connection charging arrangements.

Q4 Do you have comments on our proposed approach to implementing our rules?

Our major concern is that the proposed implementation arrangements give neither adequate time for meaningful consultation and consideration of options or provide safeguards that they will be workable, from a self-lay perspective, prior to implementation. This to us, having gone through 2 rounds of detailed consultations with

both Defra and Ofwat to just cover relatively high level aspects of the new arrangements, is incongruous.

So, instead of a controlled and managed roll-out overseen by the water industry Regulator, we are left with water companies, who control the detail of what is going to be charged, free to implement without any requirements:-

- for a formal consultation process; or,
- to publish draft 'charging arrangements' prior to implementation; or,
- to undertake a qualitative impact assessment on how their proposals will impact on customer groups or types of developments; or,
- to get Ofwat sign-off prior to implementation.

Without the above safeguards it is possible that the first our members will see of new (local) charging arrangements is, on 1st February 2017, when they should all be published. At which time they could be at a critical stage in preparing to deliver works for developers early in

2017-18 and then find themselves needing to comprehend the nature of the charging changes and how they impact on the operation of their businesses. (This may well need to be done many times over given the expected lack of 'charging arrangement' standardisation). The short implementation period and constrained, even if water companies are open enough for it to happen, time for consultation poses unacceptable levels of risk to the ongoing viability of the businesses of our members. Especially as they know that reactive Ofwat investigations, should they be minded to carry them out, can take years and, whilst they are ongoing, Self-lay Providers will be unable to take the financial risk of tendering for new work.

Hence, for annual updates, we call for Ofwat to require all water companies to publish their draft 'new connections charging arrangements' in advance and to hold a consultation for a minimum of 1 month prior to the final version being published.

On initial implementation we however think that such a timescale is unreasonable and a longer (perhaps 6 months) notice period is merited. Such a period giving opportunities for staged deployment which starts with the publication of draft 'local charging arrangements', each being accompanied by a detailed impact assessment, and a formal consultation stage. This is because the nature of the changes will need time for Self-Lay Providers to work through and to brief their developer customers. Also, with ongoing schemes, for transitional arrangements to be put in place.

We also regard it as essential for Ofwat commits to being geared up to immediately intervene should either local charging arrangements, or the accompanying consultation, identify stakeholder concerns about what a water company is proposing.

Q5 Do you agree with the approach we have taken to our draft impact assessment? Can you provide quantitative figures in terms of the potential benefits or costs? Is there anything we have missed?

Whilst we have only site specific data to draw upon we have the following concerns about the impact assessment that Ofwat has produced.

Comments on claimed Key Benefits

- i) The claimed environmental benefits of the new arrangements providing a signal against areas where development would cause unsustainable abstraction cannot be realised. This is because the new connection charging arrangements do not relate to 'supply works' or 'bulk transportation' (as these are upstream of 'network reinforcement' works).
- ii) Although site specific disputes may reduce we contend that there will be more disputes about the new connection charging arrangements themselves and the increased cost of these needs to be included in the impact assessment.
- iii) Our view is that the, so called, 'first mover disadvantage' is over played and there is adequate provision in the current legislation for companies to respond in ways which equitably shares costs between developers.

Comments on claimed Key Costs

- i) The assessment has only considered the cost impact on Ofwat. Our members, as businesses specialising in self-lay provision, contend that there is a high risk of rushed through changes disrupting their market place. This would mean loss of projects to them which could result in business closures and lack of capacity to deliver new connections work for developers and thereby diminish their ability to deliver against new home building targets. Hence all potential costs should be considered in the impact analysis.

Comments on claimed Risks and Uncertainty

- i) The issue with the intended approach by Ofwat to take remedial action should, in reality, the 'circumstances warrant it' is not sufficiently proactive to provide any meaningful safeguards to Self-Lay Providers. This is because they could well be forced to go out of business before Ofwat takes any action. Hence we regard it as paramount that Ofwat mitigates this risk by having a process which tests, such as examining charging impact against prescribed development scenarios, before company specific new connection charging arrangements are allowed to be introduced.

Comments on Distributional Impacts

- i) We cannot foresee circumstances whereby any significant change to the current charging arrangements does not create distributional impacts on particular customer groups (as this is, surely, always the case when different charging arrangements get introduced but the total amount paid remains static). Hence we feel that the Ofwat assessment is flawed and an assessment is required which considers the impact on, say, developments which hitherto have a) been able to be supplied without any off-site network reinforcement work and b) require off-site network reinforcement work which extends to a supply source and which have hitherto been required to both pay infrastructure charges and contribute towards all of the identified off-site mains work.

Q6 Do you have any comments on the drafting of our new connections rules?

Our comments on the draft wording are:-

1. We consider that, to avoid any confusion with other 'charging arrangements' that the terminology used in relations to new connections, both mains and sewers, should be "new connection charging rules" and "new connection charging arrangements".
2. Unless process refinement (see 'Point of Connection' definition in Q1[f]) makes advance modelling superfluous the new connection charging arrangements need to cover all of the work associated with supplying new developments. This should therefore include costs associated with the 'pre-development enquiry' stage and also, for self-lay, the 'point of connection' assessment stage. (These being the stages where modelling costs may arise).
3. Many water companies levy some form of 'water for construction' charge to fund water used by the developer during the building stages. Often the amounts charged is thought to be based on historic construction techniques and has not been reduced to take account of pre-mixed concretes and mortars now used during construction. Although the 'charges scheme rules' (in Appendix 2) discuss assessed charges it is unclear whether the coverage of this extends to 'water for construction'. Hence this merits clarification.
4. The 'asset payment', assuming that income offset continues to be part of this calculation, is derived from a 'cost of provision' rate and the 'income' offset'. It would aid the process if the mechanism for determining 'cost of provision' was required to be stated in the new connection charging arrangements (as this would assist Self-Lay Providers in knowing the rates in advance of having to submit a scheme specific application).
5. Whilst the meaning of 'asset payment' is known it is unclear, when it is used in the proposed charging rules, whether the reference is to the 'gross asset payment' or 'net asset payment'. ('Gross' being before the deduction of any charges associated with non-contestable works and 'net' being the amount the self-lay provider actually gets paid). Hence both categories merit being described in the charging rules.
6. Given the importance of the 'Point of Connection' (as, to us, this forms the divide between site specific work and general network reinforcement) we feel it is essential for this to be defined in the charging rules. Our suggested definition being given in Q1(f). Note – there maybe merit in extending the definition of 'site specific' to include 'associated works (at or downstream of the 'point of connection)'.
7. We feel that it would be helpful for "non-contestable work charges" to be defined (as these should be detailed in the new connection charging arrangements). Our

suggested definition being “recoverable costs payable for non-contestable work done by a water company”.

8. The term ‘requisition charges’, which is used in the draft rules also needs to be defined.
9. For the reasons expressed elsewhere in this response we consider that it is not reasonable for water companies to be permitted to give just 2 months’ notice of their new connection charging arrangements. This is because our previous experience of dialogue with water companies, both individually by FWC members and collectively as an association, does not give us confidence that the concerns of the self-lay community will be thoroughly analysed before decisions on charges are made. To rectify this we regard it as essential that Ofwat require all water companies, on their initial introduction, to publish their draft charging proposals a minimum of 6 months prior to implementation and, with subsequent updates, in a draft form for a minimum 1 month period prior to the required 1 February publication date. This would allow the time necessary for lobbying for any changes to be done in advance of the notice period.
10. We consider that the current wording in clause 9 (under publication and transparency) leads water companies towards seeking to charge against a range of activities that are not always recoverable. To lessen this issue we ask that ‘any’ is inserted between ‘include’ and ‘relevant’ (in line 6 of this clause).
11. Our view is that worked examples are a necessity to fully understanding how future schemes are to be charged away from a critical time when the developer is looking for firm tenders. Hence we consider it essential that the word ‘consider’ is removed from clause 12 (under publication and transparency).
Note – in our April 2016 response to Ofwat we set out the scenarios we thought it would be helpful for water companies to cost and test their charges against. For ease of reference these scenarios are appended to this response.
12. FWC members routinely encounter situations where water companies enhance new main provision to improve network flexibility (through providing multiple feeds to an area or cross connecting to support existing systems). This goes beyond the ‘pre-existing deficiencies’ covered by clause 27(b). To avoid future uncertainty about what is permissible we ask that ‘or enhance network flexibility’ is added to the restrictions in this clause. In our view it would be helpful to support this by now introducing the concept of ‘minimum design criteria’ which specify that where multiple feeds/connections are required these should be funded by the water company.
Note – enacting this provision needs facilities to be put in place in the rules requiring water companies to fully reimburse providers for the cost of any additional work.

13. Upsizing can also occur within a site (typically for providing carrying capacity to supply subsequent development) so we regard it as essential that the asset payment a Self-Lay Provider receives gets enhanced where such situations arise. For this proposed rules clause 27 needs be replicated under the asset payment section.
14. With regards diversions it is surely now reasonable that water companies offer betterment in the same way as they do when mains and sewers are diverted for highway works. This is because they gain from getting new assets, often to replace aged infrastructure.

Q7 Do you have comments on the draft changes to the charges scheme rules?

See comments made under Question 6

Q8 Do you have any comments on the drafting of our proposed licence modification, including the wording of the illustrative example.

No comments

Finally we ask Ofwat to note that the industry is moving away from the term Self-Lay Organisation (or SLO) to that of Self-Lay Provider (or IWCP - Independent Water Connections Provider). We feel that it would be timely for Ofwat to make this change in the documents they now publish.

I trust the above comments will be considered and be of assistance when finalising the 'New connections Charging' rules. Should you need further clarification on any point please do not hesitate to contact me on the number below.

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