

FAO: Charging Team

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Dear colleagues,

NEW CONNECTION CHARGING - CONSULTATION

Thank you for the opportunity to comment on the new connection charging rules. We are pleased to see the discussion and responses to the earlier 'Emerging Thinking' paper in March this year have been reflected in the statutory consultation. As a result we only have a limited number of comments on the approach, and are supportive of the proposals overall.

The objectives of increasing transparency and predictability of charges for new connections are important, both for maintaining the trust and confidence of developers and wider stakeholders in the sector, and also for ensuring that the much needed growth in the house building market can be enabled for the best possible outcomes. South West Water strongly supports this objective given the pressing need in the regions that we serve for the development of new affordable homes in areas of economic opportunity.

We support the aims to provide clearer and more accessible information for developer charges, and agree with the proposals to encourage greater stakeholder and customer engagement in developing the charging framework. South West Water has worked hard to develop strong relationships with developers in the region and will continue to build on this approach to ensure that developers and stakeholders are well informed, involved and have opportunities to influence the way charges for new connections are formulated.

We are pleased to see that the proposals allow water companies to take ownership of the charging approach, and provide suitable flexibility so that the industry can develop charges that are appropriate and proportionate. In view of the tight timescales for implementing new charges by April 2017, a flexible and evolutionary framework will support a considered approach and allow for the phasing of changes to charges, should companies and their stakeholders wish to take such an approach. As Ofwat acknowledges, the framework is complex and therefore the rules are likely to evolve, and it is important that the same consideration is afforded to companies' charging scheme development. We look forward to ongoing dialogue with Ofwat and customers as charges are developed over time.

Similarly, we support Ofwat's approach to not requiring payments for sewerage assets to become mandatory. Whilst there is strong logic in favour of implementing the same approach

as in water assets, the consequences would place an undue burden on the general customer base if implemented immediately. We recognise that this may be a future aspiration for the sector and will look to develop potential options for addressing the issue ahead of the next Price Review period.

We have provided comments on the detailed consultation questions and proposals in an appendix attached to this letter and look forward to further ongoing dialogue as the framework develops.

Yours Sincerely,



Iain Vosper
Regulatory Director

APPENDIX: RESPONSES TO CONSULTATION QUESTIONS

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

- As outlined in the March 'Emerging Thinking' discussion paper, we support the key features of the proposal and are pleased to see the overall approach has been retained in the statutory consultation. While there are a number of updates and clarifications from the March document, we are pleased to see the evolution of thought in this area, and that the responses and comments from earlier discussions have been reflected in the consultation.
- We agree with the approach to ensuring parity between the four overarching principles for charges outlined by Defra, and consider that companies are best placed to deal with any tensions that arise between the objectives directly with customers and stakeholders. The inherent flexibility in the proposed rules enables and empowers companies to develop charging frameworks that can best suit the requirements in the local area and we consider this a significant benefit from the approach set out by Ofwat. However, we are mindful that developers may be dissatisfied with such an approach as it is likely to result in more divergence across regions in charging approaches, rather than standardisation. It will be important to ensure that companies communicate appropriately with developers and that stakeholder engagement offers genuine opportunities for developers to contribute to and influence the approach to charging.
- In particular, we agree with the proposals not to require mandatory payment for sewerage assets at this time. Whilst there is strong logic in favour of implementing the same approach as in water assets, the consequences would place an undue burden on the general customer base if implemented immediately. However, we are mindful that water company ownership of these assets would represent the best outcome in the long run, as it will reduce the number of private sewers in operation, and ensure alignment with the recent policy for the adoption of private sewers. We recognise that this may be a future aspiration for the sector and will look to develop potential options for addressing the issue ahead of the next Price Review period.
- We are pleased that Ofwat have maintained the proposal to set a general requirement for companies to consider the role of charging structures that send environmentally beneficial price signals when developing their charges. We consider that a light touch approach to the assurance for the approach would be appropriate and proportionate for the general requirement, and would not like to see the regulatory burden of proof increase as a result.

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

- Overall, we agree with the updates to the proposed rules and consider the further clarifications helpful for setting out in a transparent way the expectations for companies in developing charging rules.

Fair Charges: Sewage Treatment Works & Infrastructure Credits

- We agree with the clarification that companies should not recover costs from developers for improvements at sewage treatment works under a requisition agreement. South West Water has not recovered these costs from developers for a number of years, as following feedback from stakeholders, we acknowledged that such a charge was not transparent or fair for customers.
- We are particularly pleased that the rules clarify companies are not prevented from offering infrastructure charge credits for previous usage. South West Water currently does offer infrastructure credits and is looking to continue the approach in the future, subject to stakeholder approval. We will publish our approach and rules for infrastructure credits to ensure that the approach is transparent to all stakeholders and can be clearly understood and implemented. We recognise that developers would prefer a consistent approach across companies to infrastructure credits, and so we will continue to work closely with stakeholders to reflect their requirements and preferences in our own approach.
- We welcome the new rule requiring companies to set their charges, income offsets and asset payments in such a way as to promote effective competition for contestable activities. As we already apply the same charging rules (irrespective of if it is a self lay or not), we are already implementing such an approach.

Reporting Information and Publishing Tariffs

- In terms of the clarification that a more granular level of cost information in relation to developer services will be required in the annual performance report for 2017-18, we recognise the benefit of such an approach and agree that it will enhance the transparency and consistency in reporting cost information.
- We welcome the clarification that the forthcoming wholesale charges rules (as referred to in IN 16/02) would not apply to charges to developers and other end-user customers for new connections. Clarity surrounding the regulatory requirements for the publication of tariff and charges data is important for maintaining the trust and legitimacy in the sector. While the link between wholesale indicative and final wholesale tariffs and connection charges cannot be completely decoupled as a result of the single-till approach and the need to forecast connection charges as part of the wholesale process; the clarification that the publication timetable is separate is welcome.
- We consider the expectation to signal any significant changes to charges early in the process are reasonable and desirable for customers. Early engagement will benefit both customers and companies by allowing consideration and potential mitigation of issues arising. The proposal to allow the phasing-in of significant changes will support the process. In terms of the projection of charges where they may not be stable, we support the proposal for companies to publish indicative charges for future years, but caution that this may only be plausible for charges in the current AMP period due to the forecasting complexities and uncertainties of price review methodologies beyond that time horizon.

- We welcome the proposal for companies to consider phasing in charges, if significant increases in the customers' charges are anticipated. Such an approach provides flexibility for companies to manage the potential consequences of changes to charging and to smooth any impacts over an acceptable time period. We would anticipate any such phasing approach would need to be evidenced by support from customers and stakeholders. Similarly, we support the clarification that the rules do not prevent companies from trialling new ways of charging and allow companies to pursue innovative and customer centric approaches where appropriate.

Transitional Arrangements

- We agree with the proposals for transitional arrangements, and consider it appropriate that these arrangements should last until April 2022 as it will be particularly pertinent for large and complex development sites already in progress. It will be important that transitional sites can be considered on a case by case basis, as which charging approach is the most appropriate will depend on a number of factors, and such flexibility will allow for the most appropriate arrangement to be agreed by all parties involved
- We support the proposal to provide regulatory stability and avoid unnecessary complexity by maintaining RPI as the measure of inflation for the full five year transitional period for infrastructure charges.

Company Assurance & Monitoring Framework

- We welcome the clarification of the expectations surrounding Board assurance, and also of the flexibility should a company wish to amalgamate various statements of assurance. This will allow companies to find the most efficient and effective approach to managing assurance processes and will ensure that any links with wider business processes (such as the wholesale charges scheme or reporting requirements) can be incorporated.
- We would welcome further detail and clarification around the proposals for charging to form part of the company monitoring framework. Whilst we agree with the principle, we are concerned that it may result in a regulatory burden on companies, particularly where it may be more appropriate for the market to oversee this activity. We would expect that, given the increase in engagement and assurance activities directly with stakeholders for setting charges, that additional regulatory oversight through the company monitoring framework should not be necessary. An alternative approach would be for Ofwat to monitor the developments of a light touch assurance approach, and only step in and require companies to include it in the monitoring framework if the approach does not evolve as anticipated.

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

- Yes, we agree in principle with the proposal to offset the infrastructure charge, rather than the requisition charge. As outlined in the consultation, there are a number of benefits to the approach which include reducing the complexity for developers,

improving cost reflectivity and ensuring there are no distortions in the competitive self lay market. We agree with the proposed April 2020 introduction date.

- However, as noted by Ofwat, there is a potential for it to result in end customers paying more as companies seek to recover the revenue deficit through the single till approach. We agree that if this occurs it has the theoretical potential to place undue bill increases on customers, which could in turn create affordability issues for some. The charges scheme rules will provide some protection for customers in the form of impact assessments and the statement of significant change, however we suggest further protection may be afforded by companies reporting via their Annual Performance Report any incidence impacts resulting from the change to offsetting the infrastructure charge. We strongly support the maintenance of the balance of charges within the single till between developers and other customers, and while we support the logic of the proposal its impact, if introduced, should be assessed.

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

- We agree with the proposed implementation dates and consider that, for years commencing April 2018 onwards, this will be appropriate. However, in view of the very tight timescale for this year requiring publication by 31 January, it needs to be recognised by all stakeholders that there will be a trade-off between developing and implementing a fully formed and robust approach supported and informed by stakeholder engagement, and the need to meet a very compressed timetable.
- We are encouraged that the flexible and evolutionary framework will support a considered approach and allow for the phasing of changes to charges should companies and their stakeholders wish to take such an approach. As Ofwat acknowledges, the framework is complex and therefore the rules are likely to evolve, and it is important that the same flexibility is afforded to companies in designing and implementing the new charging schemes. We look forward to ongoing dialogue with Ofwat and customers as charges are developed over time.

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've missed?

- We note that the impact assessment only includes qualitative discussion of the potential costs and benefits of the charging proposals. In line with the requirements in the UK Government's Enterprise Bill to bring Ofwat into the scope of the Regulators' Code and the Business Impact Target, which requires impact assessment for any qualify changes to regulatory policy to be provided, we would expect a robust impact assessment to be carried out.
- In particular, the potential costs to companies of implementing a new approach, alongside the increased requirements for customer and stakeholder engagement, and regulatory reporting and assurance should be included. We note that similar information has previously been requested by Ofwat as part of the impact assessment for the PR19 framework, and suggest this could be used as a starting point to develop a quantitative assessment.

- As highlighted above, where there are potential consequences for increases in end-user charges resulting from changes to the charging approach, we consider Ofwat should consider the potential impact to inform a quantitative impact assessment.

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

- We do not at this time have any comment on the draft connection rules as presented in the consultation.
- However as the new connections charges regime develops we would support ongoing dialogue between Ofwat and companies to inform the evolution of the rules to enable them to support both Defra's and Ofwat's objectives. We look forward to participating in those discussions.

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

- We welcome Ofwat's clarification in relation to the proposed approach in relation to the treatment of infrastructure charges in the charges scheme rules and note that with the exception of the amendments made to the charging rules in relation to rules 26 to 32, and the introduction of definitions for 'charging year', 'infrastructure charges' and 'network reinforcement' that the rules remain unchanged from 2016/17 rules issued in November 2015. For completeness we would welcome clarification that no further amendments to the rule, as proposed in the consultation, can be expected for 2017/18 charges schemes.
- The detailed nature of rules 26 to 32 clarify Ofwat's expectations in relation to the treatment of infrastructure charges from April 2017 and will aid transparency, contributing to enabling stakeholders to understand the transition to the new regime.

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

- We agree with the proposal for paragraph 16.1 and welcome the flexibility this will offer in terms of calculation of charges and the way in which it can be presented to customers.

