New Connections Charges for the Future – England, 5 July 2017 Consultation

Albion Water Response

Albion Water is a NAV company that currently operates at three locations across the south of England. For the water supply service, Albion Water operates on a bulk supply basis but for waste water we operate on a full-service basis, i.e. we provide the local connection, sewerage, sewage treatment and discharge infrastructure. For two of the three sites, we will also offer recycled non-potable water from local sources (SUDs rainwater capture plus recovered wastewater).

We welcome the changes proposed in this consultation, particularly as they apply to bulk supply NAVs. However, we have concerns over the implications for full service NAVs. Nevertheless, we see it as very useful step in Ofwat's journey of enabling NAVs to provide an effective and efficient contribution to resilience, innovation and competition in the water industry. Although much more remains to be done, we believe that Ofwat's consultation provides a clear direction of travel.

For Albion Water the key points of the revised Charging Rules for New Connections and Charging Scheme Rules are the following.

1. Incumbents will no longer be able to provide an income offset against requisition charges, water and waste water (Charging Rules for New Connections - 29), and will continue to be unable to provide an income offset against connection charges (Charging Rules for New Connections - 33).
2. Incumbents are not required [and therefore may still choose?] to make an asset payment against the provision of assets provided by the developer / SLO. (Charging Rules for New Connections - 37 and 38).
3. Incumbents may [but are not required] to reduce the infrastructure charge by an amount that ensures that the current balance of costs is maintained between developers and existing customers for new development. How incumbents choose to apply the income offset is up to incumbents (Charges Scheme Rules – 6 and 7).
4. The new arrangement to be implemented on 1 April 2018 (Option 2a) or 1 April 2020 (2b) or 1 April 2020 with a discount on bulk supply charges from 1 April 2018 to 1 April 2020 (Option 3).
5. Infrastructure charges may, but do not have to, vary geographically (Charges Scheme Rule 33).

It would be helpful if you could advise us of any misunderstanding we have in reading your consultation and revised rules.

The consultation would have benefited from some worked examples, perhaps with notional figures drawn from your recent data request to incumbents on this matter.

Moving the income offset to the infrastructure charge

Albion Water welcomes the change to the treatment of the income offset. Applying it to the infrastructure charge will put bulk supply NAVs on a level playing field with incumbents.

Of the options you propose we support Option 2a. It should restore the level playing field for bulk supply NAVs and we can see no reason for delay. A number of questions remain about Option 2a in terms of how the revised offset will be calculated. We

assume that it will be a flat rate per property set at a level to maintain the current balance of charges. We are happy to work with incumbents to market test their approaches.

As well as clarification on this point, Option 3 would introduce a whole new area of debate as to how a reduction in bulk supply tariffs would be calculated, would it apply to existing arrangements or only ones agreed during the two-year period and what would happen at the end of this period? The additional cost to existing incumbent customers, as well as being a small amount, appears to be an accounting issue rather than a true cash issue.

We are concerned that it is left to incumbents to determine how they calculate the income offset against the infrastructure charge. Potentially an incumbent could focus the income offset on sites where there is a high requisition charge, whilst still offsetting it against the infrastructure charge. Whilst this would maintain a level playing field for bulk supply NAVs it would be particularly anti-competitive against full service NAVs. We would therefore expect you to require that the income offset, however it is calculated, to be the same amount per connection across a company area.

In terms of your impact assessment, Albion Water is disappointed that this consultation does not include a consideration of the impact of the revised, but continuing, income offsets on full service NAVs. In Footnote 2 on Page 8 of the consultation, you state, "*Our focus is on competition for new connections, so for simplicity we do not consider these other services further in this document*." However full service NAVs do compete for new connections and will continue to be disadvantaged with respect to incumbents and bulk supply / discharge NAVs by the proposed changes.

This is doubly disappointing as full service NAVs provide additional capacity, resilience and competition rather than just replicating assets that an incumbent or an SLO would provide.

It is noticeable in both the NAV review and this consultation that your focus is almost exclusively on bulk supply/discharge NAVs and not full service NAVs. Whilst it has been argued that this is because most NAVs are bulk supply/discharge NAVs, we would regard this as being a symptom of the playing field being particularly loaded against full service NAVs.

On Page 10 you rightly identify the critical issue for bulk supply NAVs "*Critically though, incumbent water companies generally do not offer NAVs an equivalent discount*." However, this imbalance applies equally to full service NAVs competing against incumbents and bulk supply NAVs – however, you offer no proposals to deal with this.

We are surprised that you did not consider the option of abolishing the income offset. Whilst we appreciate that there is a desire to maintain a balance between existing customers and developers, it is not compatible with competition law to increase charges for customers who do not have a choice (existing monopoly customers) to subsidise customers who do have a choice (developers). Whilst all your options allow for developers working with bulk supply NAVs to receive this subsidy, developers working with full service NAVs would not. The provision of offsets, even against the infrastructure charge, therefore remains anti-competitive against full service NAVs.

In our response to the NAV review we proposed a method of maintaining the balance in a manner that was not anti-competitive against full service NAVs. This was for all companies to pay into a national (England) or regional pot on a per existing connected property basis, at a rate necessary to maintain the current balance, and take out of the pot based on new properties that they or any NAV or SLO connect in any one year. It is regrettable that you do not appear to have not considered this option.

Asset payments

We are unclear why, and it seems inconsistent, for incumbents still to be able to make asset payments (Charging Rules for New Connections - 37 and 38). Surely any such payments would distort the level playing field in exactly the same way as income offsets do? It is noticeable on Page 47 of the consultation you state for Rule 38 that asset payments should not be made – which seems inconsistent with the actual wording of the rule.

It would appear that an incumbent who chose to ignore this provision would need to be able to justify any such payment made, in the light of Ofwat's clear guidance and prevailing competition law.

Infrastructure charge

We are pleased that the Charges Scheme Rules make it clear (Rule 33) that the Infrastructure Charge can vary geographically. This is essential for fair competition so that developers pay the full cost of their impact on the local network and to allow full service NAVs to compete in providing more cost-effective solutions that avoid network reinforcement (such as on site waste water treatment and recycled non-potable water). To ensure that their charges are not anti-competitive we therefore expect incumbents' infrastructure charges to be set to reflect zonal network constraints.

NAV review

We are pleased that you will be engaging with stakeholders this summer on your findings from the NAV review. As well as the income offset / asset payment issue there are a number of areas where NAVs (and full service NAVs in particular) are placed at a competitive disadvantage to incumbents. These include:

- The asset value discount at privatisation resulting in incumbent retail charges not being reflective of an incumbent's full historic costs – and this retail charge then being a cap on a full service NAV's retail charge.
- Incumbents funding water resource and sewage treatment assets from their many existing customers, whilst for a full service NAV these must be funded by the developer or income received from the (relatively speaking few) retail customers who will live on the development.
- Long term stability in the incumbent's infrastructure charge if full service NAV's charge is also capped at the incumbent's charge.
- Incumbents having market dominance in terms of information to developers, and the lack of an open market in providing water services to developers.
- The NAV application process.

Next steps for Albion

Albion Water is prepared to work with any incumbent to discuss and, where requested, provide a market assessment, of any work leading to the introduction of these charging rules from April 2018. We have already had some positive feedback and would encourage all incumbents to engage with us or with other NAVs who are similarly prepared to engage in such market testing.