CONFIDENTIAL TO OFWAT

10th August 2017

Charging
Ofwat
21 Bloomsbury Street
London
WC1B 3HF

By email: charging@ofwat.gsi.gov.uk

Dear Sirs

Response to consultation – New Connections Charges for the future

I am writing on behalf of Icosa Water Services Limited (Icosa) in response the above consultation that was published on 5 July 2017. We welcome the opportunity to contribute to the consultation.

By way of introduction to Icosa (a wholly owned subsidiary of Icosa Water Limited), the company was established with a view to operating as a new appointee and competing for the construction, adoption, operation and maintenance of water, sewerage and environmental assets and delivering water and sewerage services to consumers on new housing developments. Icosa thus intends operating as a water undertaker and as a sewerage undertaker following its appointment under sections 6 and 7 of the Water Industry Act 1991.

Our responses to the specific questions raised in the consultation document are set out in Appendix 1.

On a more general note, Icosa supports the need to change the charging framework in a way that will support DEFRA's overarching objectives and comply with the principles of better regulation by creating a level playing field for new connections services.

In addition to the charging framework currently being considered, we look forward to working with Ofwat on its ongoing review of the NAV market initiated with Frontier Economics in December 2016.

Whilst we fully support Ofwat's customer-focused approach to the new connections charging framework, Icosa considers it necessary that a similar approach is necessary through the broader regulatory framework to facilitate a healthy competitive market for new connections.

Icosa strongly believes that a revised charging framework and different treatment of the income offset (as contemplated by Ofwat in its consultation) will go a long way to achieving a level playing field for connections services and improve transparency. Icosa recognises that pricing, predictability and transparency for new connections are critical factors to developers in choosing utility service providers; however, levels of service and confidence in the NAV process are also factors that drive developer decisions. Icosa finds itself at an obvious disadvantage when competing on levels of service to developers (such as providing optimum operational and technical solutions for a potential development site) when Icosa's ability to deliver good services to developers is jeopardised by dilatory incumbent behaviour in providing services to Icosa (such as capacity check results and technical off-site solutions for the development – in some cases proposed solutions don't appear to be lowest cost engineering solutions but instead appear to be over-engineered), and on which Icosa, and developers, ultimately depend.

Icosa believes that these additional issues, when resolved, will improve the way in which new appointees will be able to compete with incumbent monopolies to facilitate the delivery of better services to developers and consumers. We have explained these briefly below:

Inset application process

Icosa considers more certainty of timing as one of the most important factors of this process. The current 110-day process is already too long and is possibly compounded in instances where Ofwat suspends the assessment timetable to gather further information. Icosa recently responded to a bid invitation from a consultant acting for a developer.

Despite the terms being favourable, the developer chose not to use Icosa on the grounds that the NAV process was slow and that certainty of it being awarded was not clear until the very end of the process.

Standardised access terms

Icosa is aware that negotiating bulk supply and bulk discharge agreements is a time consuming and expensive process for new entrants. In some instances, deliberately obstructive behaviour by incumbents can jeopardise a project and increase the likelihood of such a project defaulting to the incumbent. We believe that most bulk supply and discharge terms should be common across all incumbent regions with possibly a few minor area specific terms to cover any unique attributes of a particular region or development site. Like the section 104 adoption agreement, we would strongly support a standardised set of terms to be used by incumbents and new appointees for the provision of bulk services to new appointee served developments.

Removal of licence exclusivity for geographical areas

Geographical exclusivity should be removed for inset appointments in favour of operating under a national licence in the same way that independent gas transporters and independent distribution network operators do.

Yours faithfully,

Stephen Bradley

Chief Executive Officer

APPENDIX 1

Q1 Do you agree that our Option 3 on the treatment of the income offset/asset payments, has merit? If not, please explain your reasoning and provide relevant evidence. If so, how and when should this change be brought about?

Before considering the merits of Option 3, Icosa's preference would be for the implementation of Option 2a. NAVs have, since privatisation, been at a competitive disadvantage so that it seems unfortunate to delay the implementation of any reform that would have a material impact on competition and which would ultimately benefit all customers.

Ofwat has identified mainly two disadvantages to the implementation of Option 2a, namely short-term (and small) increase in end-user bills and short-term implementation cost for incumbents. Icosa considers these disadvantages as relatively small in light of the benefits that could be brought about through the implementation of Option 2a including greater competition, better service for developers, better pricing signals and far greater transparency.

Option 3, according to Ofwat, has the benefit of avoiding the disadvantages inherent in Option 2a (temporary increases in customer bills and short term implementation costs to incumbents) whilst at the same time introducing more competition from April 2018. Whilst Icosa does not necessarily dispute the merits of Option 3 we are of the view that the lack of transparency (2018-2020) delivered by Option 3 outweighs the modest end-user bill increases, particularly given the other benefits that could be derived from earlier implementation of Option 2a. The methodologies by which bulk supply discounts are calculated to proximate income offsets are unlikely to be readily available or to provide sufficient transparency for understanding. Moreover, Ofwat recognises that the bulk supply charges are unrelated to new connections and that bundling them together would make income offset less transparent. Icosa does not accept that this disadvantage is "*only* for two years" – this is a long period of time for any NAV wanting to scale up its business.

Ofwat has the opportunity to remove these disadvantages with effect from 2018 and Icosa does not consider the identified disadvantages to be sufficiently material to warrant a deferment.

Furthermore, bulk supply prices need to be separately reviewed as they currently do not reflect to costs of delivering services to the boundary. Current prices do not allow a sufficient margin for Icosa to compete on most new development sites. The methodologies used to derive these prices lack transparency and do not appear to be underpinned by any cost reflective drivers and do not take account of the costs avoided by an incumbent in not having to own, operate and maintain the downstream network which can include 2km of off-site pipework and pumping stations; and yet despite avoiding a large proportion of the local distribution costs, incumbents continue to levy a disproportionately large part of the all the way income through their bulk supply tariffs – we believe that this would form part of Ofwat's review with Frontier Economics and addressed in the further consultation with stakeholders this summer.

Q2 Do you agree with our draft impact assessment? Can you provide quantitative figures in terms of the potential benefits or costs? Is there anything we have missed?

Icosa agrees with the draft impact assessment. Icosa recently commenced trading and not able at this stage to provide any quantitative figures in terms of benefits or costs.

Q3 Do you have any comments on the drafting of the possible future changes to our rules (set out in Appendices A3 and A4)?

Icosa agrees that the drafting proposals reflect Ofwat's proposals/preference to implement Option 3. However, for reasons mentioned above Icosa is in favour of Option 2a.

Q4 Do you have any comments on our proposed licence modification to Condition C (Infrastructure Charges) for English water companies other than NAVs (including the proposed wording set out in Appendix A7)?

Icosa supports the proposed modification.