

Northumbrian Water response to: New connections charges for the future - England

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?

We agree that Option 3 is better than Option 2a, although we prefer Option 2b. We believe that changing the income offset approach could result in a significant rebalancing of charges, both between customer groups and between types of development. We prefer an incremental approach over time, whereby there are substantial improvements in transparency and design of developer charges brought in over 2018 and 2019. These improvements should generate a view of best practice and more standardisation of approaches that should build developer confidence before the more significant financial changes from 2020.

We are concerned that these proposals have been published before the parallel NAV report by Frontier Economics is published later this year. As a key part of Option 3 is about charges to NAVs, we do not see how these proposals could be implemented without reference to the recommendations from the FE study. There is a real risk of mis-alignment of approaches or contradictions in the two sets of guidance.

We note there is no reference to the Option 3 requirement to provide income offsets as part of new bulk supply agreements over 2018-20 in the Draft Charging Rules for New Connections. Indeed, those rules specifically exclude bulk supplies (clause 3e).

We are unsure what legal powers Ofwat would be using to require such an offset, as the requirement is clearly beyond the New Connection Charging powers. To avoid dispute, it would also help if Ofwat were to clarify with an example how such an income offset could work.

Whilst income from bulk supply agreements is outside the revenue control, forecast income from bulk supplies was included when the revenue controls were set in PR14. With these proposals, Ofwat are intervening to amend a source of revenue mid period. As such, by requiring incumbents to supply water at charges below the cost of supply, incumbents will be worse off due to this intervention.

Finally, one implication of an income offset to NAV annual water supply charges is that the incentives for water efficiency for NAVs would be dramatically blunted, were they to effectively receive 'free water' for two years. This has implications under Ofwat's new sustainability duty.

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?

We do agree that Option 2a would have significant implementation costs, and we also would point out that companies are already consulting with developers under the existing guidance, so a late change would be extremely difficult to consult on and communicate in good time to developers.

Our only other observation here is that the benefits of more intense competition are framed as though the only market challenge to incumbent requisition costs is through NAVs.

In our experience, the self lay option has a larger market share than the NAV approach. This option is arguably already delivering many of the benefits of competition.

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

These seem reasonable to us.

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)?

We welcome the proposal to effectively remove Condition C. Whilst companies are likely to continue making some kind of infrastructure charge, removing the condition gives scope for innovation and flexibility on how to do so. We suggest it might help if Ofwat clearly stated that the modification does not imply the abolition of infrastructure charges, but rather the abolition of the licence rules about how they are set.

Fixed Charge exemptions

We also have some comments to make in respect of the changes Ofwat proposes in Appendix 6 of the consultation document.

We welcome the changes proposed by the introduction of rules 46. and 47. Our understanding is that these new rules are, however, limited to Requisition Charges. Their proposed introduction is in recognition that upfront Fixed Charges are not appropriate in some exceptional circumstances. We are concerned at the omission of equivalent rules in respect of Connection Charges on the basis that it is the circumstances that exist that affect certainty of pricing rather than the type of asset being constructed. The same exceptional set of circumstances could prevail for communication pipes, lateral drains etc. as they do for requisitioned water mains and requisitioned sewers, thus making pricing upfront much more difficult in a limited number of cases for Connections.

We believe that the reporting and monitoring requirements suggested in Approach 1 on pages 50-51 of the consultation are reasonable. It is our view that this would be sufficient to ensure companies have an appropriate level of exemptions to upfront Fixed Charges and that it should apply to both Requisition Charges and Connection Charges.

NORTHUMBRIAN WATER

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