

# Consultation on changes to the Charges Scheme Rules, Wholesale Charging Rules and the Charging Rules for New Connection Services

## South East Water response

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Thank you for consulting on the proposed permanent changes to the charges scheme rules, the wholesale charging rules and the charging rules for new connection services (English undertakers) following the temporary changes made earlier in 2018.

We agree with the proposed changes to the charging rules set out in the consultation document subject to one substantive comment relating to the revised definition of network reinforcement in the charging rules for new connection services (the “new connection charging rules”) and similar wording used in paragraph 30 of the charges scheme rules.

### Main observation regarding the definition of network reinforcement

The new criteria in the definition of network reinforcement set out in the new connection charging rules that the reinforcement must relate to infrastructure provided pursuant to an agreement with or duty to a person “other than a relevant undertaker”, would exclude reinforcement relating to NAV sites from that definition because new appointees are relevant undertakers. Consequently, incumbent undertakers would no longer be able to include reinforcement costs relating to NAV sites in the calculation of their infrastructure charge.

### Potential issues resulting from the change of definition

The new definition of network reinforcement in the new connection charging rules includes an additional criteria that the reinforcement works must relate to infrastructure provided pursuant to a duty to or an agreement with “a person other than a relevant undertaker”.

Where an incumbent undertaker provides a connection between the infrastructure of a new appointee to its own network in order to provide a bulk supply to that new appointee and this requires network reinforcement works on the incumbent’s network, these works will be carried out pursuant to a bulk supply agreement which is “an agreement with a relevant undertaker” (at least from the time the applicant becomes the new undertaker for the site).

Applying the new definition of network reinforcement in the new connection charging rules, these works would not be network reinforcement for the purpose of calculating the incumbent’s infrastructure charge.

Paragraph 28 of the charges scheme rules defines how infrastructure charges must be calculated and in particular which costs incumbent undertakers are allowed to include in the calculation of the infrastructure charge. It provides that the infrastructure charge must be determined to cover the costs of network reinforcement as defined in the new connection rules.

If reinforcement works relating to NAV sites do not fall within the definition of network reinforcement, incumbent undertakers would no longer be allowed to include the relevant costs in the calculation of infrastructure charges. It would also seem to follow that they would no longer be able to receive the amount of infrastructure charge collected by new appointees as is the current practice.

New appointees currently bill infrastructure charges that are equal to the relevant incumbents' infrastructure charges and the sums collected are then remitted to the incumbents. The infrastructure charge is meant to cover all relevant network reinforcement costs incurred by the incumbent including those relating to NAV sites. Incumbent therefore need to be able to include these costs in the calculation of their own infrastructure charges so that new appointees can then apply the correct equivalent infrastructure charge.

It is also the intention as stated on page 22 of Ofwat's November 2017 decision document: New connection charges for the future (England) that "from 2020 incumbent water companies will provide an income offset to all customers including NAVs. The income offset would be netted off the infrastructure charge and asset payments would be removed and replaced by an identical income offset".

If the effect of the new definition of network reinforcement is as we described above, this is not consistent with the current practice for dealing with the infrastructure charge between incumbents and new appointees or with the future plan for the recovery of the infrastructure charge less the income offset from 2020.

Paragraph 30 of the charges scheme rules complements paragraph 28 by setting out additional details on the costs that can be included in the calculation of infrastructure charges. It provides that the infrastructure charge must only relate to costs of genuine reinforcement relating to (a) the provision of new water mains pursuant to a duty to or agreement with a person other than a relevant undertaker, (b) self-lay, or (c) connections as defined in section 146(2) of the Water Industry Act 1991.

Leaving aside the proposed new definition of network reinforcement, the calculation of incumbents' infrastructure charge can include the costs of network reinforcement relating to NAV sites because these costs relate to connections as defined in section 146(2) of the Water Industry Act 1991 (i.e. connections to premises never connected before even if they are not in the supply area of the incumbent) and fall within paragraph 30(c).

However, this is no longer possible with the new definition of network reinforcement as paragraph 28 refers to network reinforcement (as defined in the new connection charging rules) which excludes reinforcement works relating to NAV sites (because new appointees are relevant undertakers).

Even if it was considered that incumbents and new appointees can continue to agree that new appointees will charge an equivalent infrastructure charge and pass the amounts collected from their own customers to the incumbent, there would still be a discrepancy in the amount of the infrastructure charge as undertakers would be unable to include the amount of reinforcement relating to NAV sites when they set their own infrastructure charges. Incumbent undertakers would therefore be unable to recover these reinforcement costs. They would need to review their agreements with new appointees.

This would be contrary to the stated assumption in the consultation document that the proposed modifications would not require undertakers to change their infrastructure charges.

If the intention is not to change the policy relating to infrastructure charges between new appointees and incumbents or to exclude reinforcement works relating to NAV sites from the

definition of network reinforcement in the new connection charging rules, then that definition should be amended to clarify that network reinforcement includes reinforcement works carried out under an agreement with a new appointee. For consistency, a similar clarification could also be included in paragraph 30 of the charges scheme rules.

Alternatively, if another interpretation of the charging rules as amended is possible, we would appreciate if this could be explained in the decision document.

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