

New connections charges for Welsh companies – consultation

Hafren Dyfrdwy response

January 2019

WONDERFUL ON TAP



Summary of response

We welcome the opportunity to respond to the above consultation and look forward to seeing the decision document when it is published afterwards.

We are wholly committed to setting charges which are simple, predictable, transparent and fair and we acknowledge the benefits behind setting principles-based rules as we have seen introduced for new connections charges in England.

We welcome the opportunity to make changes to the charging framework which ensure the principles outlined in this consultation are achieved however we are also mindful that the increased costs of implementing a new charging structure which meets a set of principles-based rules (option 2) are significant for a small company like Hafren Dyfrdwy and therefore we have a preference for option 3.

We welcome the guidance from the Welsh Government and support the principles outlined in their guidance such as promoting the use of SUDS.

Specific comments in respect to each of the questions are contained within this document.

Should you require any further information please do not hesitate to contact me.

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Head of Developer Services

New connections charges for Welsh companies – consultation

Q1 Do you agree with our preferred option, option 2, for Welsh new connections charging rules?

We believe there are benefits with all three options but we have a preference for option 3.

The developer services team in Hafren Dyfrdwy also serves Severn Trent customers and we have seen the benefits of introducing the principles-based rules (option 2) in England. The key benefits we can see of introducing option 2 for Welsh companies are:

- Transparency in what charges apply and how these are applied demonstrated within a comprehensive publication
- Confidence from developers that charges are cost reflective, for example within infrastructure charges which were previously set under Licence Condition C
- Greater simplicity in how charges are structured and greater predictability through fixed charges
- Greater (or more visible) assurance and governance driven by the requirement for a Board Assurance statement and the publication of all charges
- The requirement for a meaningful consultation process.

We also see the benefit of those points noted by the Welsh government for example greater emphasis on SUDS which is aligned to our commitment to environmentally friendly practices.

However we are mindful that moving to setting charges under the new principles-based rules compared to setting charges prior to the new rules creates initial implementation costs but also some ongoing additional costs to satisfy the terms of the new rules. This is manageable for companies like Severn Trent but not as manageable for companies like Hafren Dyfrdwy.

The activity streams involved in setting annual charges do not change when a new set of underpinning rules are introduced however the time and costs invested in those streams do increase to support the implementation of new charging approaches. The principal activity streams which require greater focus and hence resource and cost when introducing notable changes to charges (either during the initial implementation or on an ongoing basis) include:

- Consulting with customers, regulators and trade bodies to ensure the new rules are clearly understood and applied, understand customer feedback in how we structure our charges to meet the new rules and clearly communicate our finalised approach.
- Assuring charges to ensure they are compliant with the new rules.
- Calculation of charges which require new or more extensive data capture process and economic methodologies to meet the new rules.

The cost of this additional work rises into the hundreds of thousands which is not material for Severn Trent but is material for Hafren Dyfrdwy and this cost will be passed onto developer customers.

The volume of work that Hafren Dyfrdwy manages and the benefit gained by introducing the principles-based rules are not proportionate to the costs involved in setting charges to meet the rules.

In Severn Trent we were able to develop simple and effective charges based on incurred costs particularly for mains requisitions (on a per plot basis) and infrastructure charges. In Hafren Dyfrdwy the volume of work is not large enough to amass a data set which would allow us to calculate simplified and fixed charges which are cost reflective for the greater majority of schemes.

Likewise, our developer-driven network reinforcement investment in Hafren Dyfrdwy is not as consistent as in Severn Trent. We may make very little or no investment for a number of years (potentially the full 5 years between each periodic review) and then make a significant investment within a single year. Using a five year average calculation to derive the infrastructure charge is therefore not appropriate. It could lead to developers in one AMP paying nothing, whereas developers in a later period would bear a disproportionate cost.

This is particularly true of Hafren's wastewater service, which has only around 26,000 connected properties. In a large area such as Severn Trent, it is likely that there will be some reinforcement activity taking place somewhere within the region in any given year and therefore averaging over a short time horizon is not unreasonable. In Hafren, we are expecting around 250 sewerage connections per year over AMP7 and no reinforcement may be necessary in the period. However, the accumulation of connections will eventually give rise to a need for investment. With a short average horizon, developers in AMP7 would get a "free ride" while developers in AMP8 or AMP9 would bear the costs.

Developers are not like regular bill-paying customers – they are not necessarily repeat customers. The firms or individuals connecting in later periods may not be the same as those who received the "free ride" in earlier ones. For all these reasons, we think that a much longer time horizon or larger area would be necessary to calculate an appropriate charge for Hafren.

Q2 Do you have any views on whether Welsh companies' charging arrangements should apply differently to single-build and multiple-build applications?

Based on our experience with Severn Trent charges we believe that a single charging arrangement can satisfy both application types but charges do need to be carefully constructed to ensure single-build and multiple-build applications are catered for.

Our experience with Severn Trent is that all four principles cannot be satisfied 100% for all charges or types of work and different customer groups place a higher emphasis on different principles.

For example, simple and fixed charges lead water companies to develop a small number of rationalised or average charges which cover a range of circumstances and are easily predicted and understood. In contrast cost reflective and truly fair charges lead water companies to set more granular charges (for example a schedule or menu of rates) to ensure customers always pay charges which acutely reflect the specific activities involved in the activity they are paying for.

We acknowledge that simple and predictable charges are more suited to multiple-build applications where developers place more emphasis on predictable charges which help them to purchase land knowing the likely

costs and typically these customers can afford to pay slightly more or less on a given scheme because they will experience a 'cancelling out' effect over many schemes. In contrast it is more important to charge single-build developers for the specific services or assets they receive as they do not have the cash flow or volume of work to benefit from broader average charges.

The charges in Severn Trent are designed around these interests such that our mains requisitions charges, which form a large part of a multiple-build developer's quote, are based on a simple per plot approach and our service connection charges, which form a large part of a single-build developer's quote, are based on a menu of rates.

Leading on from Question 1 we would not have a significant number of developers in Hafren Dyfrdwy that build in our area regularly enough to gain from having simpler 'average' charges which are easy to predict over many schemes. A pragmatic approach might be to allow small companies such as Hafren to peg their charges to those of neighbouring companies (similar to the way in which NAVs are permitted to apply a relative price control when setting their primary charges).

Q3 Are transitional arrangements necessary and if so what should apply?

We believe transitional arrangements are necessary but should be limited to simply state that any quoted schemes entered into (agreed) before the 1 April 2020 (if changes come into force on this date) will be honoured and any quotes entered into (agreed) after this date will be based on the new charges for the new charging years.

Companies should take all reasonable steps to ensure charges remain stable year on year without any unnecessary fluctuations and therefore maintaining transition periods simply adds confusion.

The Licence Condition C modification has added great confusion to the infrastructure charges applied in England. Our interpretation of this modification is that our newly calculated infrastructure charges (based on the new rules) only apply when the main or sewer that is being connected to was provided (requisitioned) after April 2018. When the main or sewer that is being connected to was provided between 1991 and March 2018 the old indexed charge (based on Licence Condition C) should be used.

This is manageable for large developers who are introducing a new main or sewer for their development however for single-build developers this is incredibly confusing as they need to understand when the main or sewer was provided before they can predict their charges. In addition it is not clear which charges companies should use before 1991.

Q4 Are there additional ways in which our charging rules could reasonably promote the use of SuDS?

We believe that other than introducing a rule to ask companies to 'consider' the promotion of SUDS Ofwat could introduce a rule which mandates the inclusion of an incentivisation mechanism when developers use SUDS.

In Hafren Dyfrdwy and Severn Trent we already offer an Infrastructure Discount Scheme which reduces or cancels out the Infrastructure charges for a given development if the homes/site has been built to our environmentally friendly criteria. These criteria ensure that homes do not use excessive amounts of water and that sites include sustainable drainage systems.

Q5 Does the preferred approach place an undue regulatory burden on Albion Eco? If so, what approach would maintain customer protections while avoiding an excessive regulatory burden?

We believe that it would place an undue regulatory burden on smaller companies including Hafren Dyfrdwy as explained within our response to Question 1.

As such, we think that a relative price control allowing small companies to peg their developer charges to those of neighbouring areas may be a pragmatic approach.

Q6 Are there additional issues, not identified in this consultation, that relate specifically to Welsh companies, which we should take into account when developing new connection charging rules?

At this stage we are not aware of any additional issues which relate specifically to Welsh companies.

Q7 Do you have any comments on the drafting of our proposed new connections charging rules, proposed changes to the charges scheme rules or proposed licence modification?

We have no notable observations other than those already covered in our previous responses.

In terms of those sections which are additional or different to the current English rules we are comfortable that we could satisfy those points for example we already include CCW as a stakeholder when we consult on key developer services issues.

We would like clarity on where income offset is proposed to be applied. In Box 3.1 it states that income offset “should be netted off the requisition charge” however it is due to be netted off against the infrastructure charge from 2020 for English companies under the English rules.

We would also like to note this consultation is being held after our PR19 submission in September 2018 and that any changes to how charges are set by Welsh companies following the introduction of a new set of rules will have an impact on how PR19 tables (namely App28) have been populated.

Q8 Do you have comments on our draft impact assessment? Can you provide quantitative figures in terms of the potential benefits or costs?

At this stage we cannot provide quantitative figures to demonstrate the benefits we outlined in response to Question 1.

In regards to costs we originally estimated that the annual implementation costs would be in the region of £150,000 when we responded to the information request in early 2018. We have reassessed these costs and now believe the annual implementation costs are closer to £250,000.