

Charging Rules for New Connections and New Developments for English Companies from April 2020

Albion Water Consultation Response, May 2019

Key points

Whilst the proposed changes set out in the new connection charging rules consultation are welcome in terms of levelling the playing field for SLPs and bulk supply NAVs, and are a much simpler arrangement than the previous DADs calculation, they do nothing to address anti-competitive outcomes experienced by full-service NAV providers. The consultation recognises the issue faced by full serve NAVs - for example stating 'full service NAVs ... will not have full access to the income offset discount' and 'Where a NAV proposes a treatment works on site, and does not propose to make use of the incumbent company's infrastructure, it would not have access to the discounts'. However, the consultation proposes no solution to these issues.

There is recognition that the changes proposed will have no impact on correcting significant barriers to entry experienced by full-service NAVs and, in fact, serves bulk supply NAVs with a competitive advantage over the full-service offering. This outcome risks stifling innovation and greater water industry resilience associated with the provision of local distribution, treatment and recycling services – leading to inefficient solutions being delivered that can cost many £millions more and increases the water charges to all regional customers.

It is noteworthy that on Page 1 you state that these changes will "contribute to a level playing field". It is very disappointing that nearly 30 years after privatisation this is only just being achieved for bulk discharge / bulk supply NAVs and there is still all to do for full serve NAVs. In its charging rules Ofwat should be seeking to mitigate for the monopoly position of the incumbents by introducing rules that encourage and mimic competition rather than thwart it.

It is therefore also very disappointing that you have not taken this opportunity to consult on the changes necessary to achieve a level playing field for full service NAVs. This is surprising as it is an issue we have raised repeatedly with Ofwat for well over two years.

On the particular issue of income offsets, Ofwat's charging rules or other guidance must specify that if companies are going to continue with an income offset then the companies need to put in place measures to ensure that this cross subsidy from existing customers, who do not have a choice of supplier, to developers who do have a choice, is not an abuse of their dominant position in the market resulting in the inability of efficient alternative full service providers to compete.

Ofwat's new connection charges should also require that:

- Infrastructure charges should be zonal – or if they maintain a regional charge they need to do it in a manner, or have other measures, that do not put full serve NAVs at a disadvantage in serving sites which are expensive for the incumbent to serve
- Where a new development requires significant network infrastructure or treatment upgrades then the provision of bulk water and/or bulk treatment should be open to the market and incumbents should put in measures to ensure that this market is not distorted by their internal cross subsidies.

Detailed comments

On Page 6 you highlight that one of the original problems that you have been trying to address is that "costs for network reinforcements were not fairly apportioned across different developments".

On Page 9 you say that “we are keen that water companies make more use of infrastructure charges that vary by geographical area”. To solve the problem you have identified, rather than being “keen” you should be making zonal infrastructure charges a requirement. To do otherwise allows companies to perpetuate charges that are anti-competitive.

On Page 8 you state that you have written to water companies regarding compliance with competition law and charging rules obligations. Given the barriers evident for full service NAVs, will you be writing to companies in the same vein?

On the bottom of Page 9 you highlight some of the issues faced by full service NAVs. You say you “may consider whether further reforms are merited”. Why only may? What possible reforms have you considered? In our discussions you recognise the issue, but you have not tabled any solutions that you are thinking of.

You do not specify how the income offset should be applied against the infrastructure charge, e.g. flat sum per connection or percentage of infrastructure charge or percentage of requisition cost. We are firmly of the view that the provision of any income offset is anti-competitive (unless companies put in other measures to overcome its anti-competitive effect). However we have already made it clear to a number of companies that an income offset applied equally (in cash terms) to all new connections will distort the market less than one which increases with the value of an associated requisition or zonal infrastructure charge. We therefore expect the charging rules to specify that the level of income offset must not vary as a function of cost of providing the connections.

By way of comment, the sentences of the Government’s policy quoted at the bottom of Page 11 always appear to us to be contradictory. The second sentence says the balance should be broadly maintained (i.e. a transfer of money from the general customer base to pay for the impact of development) whilst the third says the general customer base should not bear costs in relation to new development. Which is it? In addition to the income offset one of the points that we have raised with you repeatedly is that the general customer base is bearing the cost of sewage treatment works enhancement caused by new development. This appears to be contrary to Government policy.

In New Connection Rule 19 we would recommend that you try to include the word “proportionate” to make it clear that you are expecting the relative proportions from developers and the general customer base to be maintained and not the absolute aggregate amount.

By way of clarification on the Rule 28 this means that companies should be setting their ICs based on a two year historic look back and a three year forward look of their expenditure? Have you thought through how this might work with zonal infrastructure charges where development in a zone takes place over a 20 to 25 year period?

Responses to questions

- 1. Do you have any comments on the proposed wording for the New Connection Rules and Charges Scheme Rules (see Appendix 1 tables, and the rules for consultation), which will come into effect from April 2020?*

We have made a number of comments above on the Rules. Otherwise Albion Water is content with the proposed Rules. It would help to clarify the definition and charging arrangements associated with capacity enhancement works required outside (and as a result of) the development site – i.e. in the event of a connection to a local main of matching diameter but with no available capacity.

2. *Do you have any comments on our proposal to introduce an information requirement on bill stability?
More specifically:*

*Do you find the proposed requirement helpful in supporting the charging principle of bill stability?
Is the suggested 10% threshold for significant bill increases appropriate for striking the right balance
between more scrutiny on bill increases and flexibility for companies to make changes as necessary?*

*In order to assist companies in implementing this requirement effectively, we welcome views on:
what criteria would be most appropriate to define typical new developments; and
what services should be included in a typical package?*

In order to establish a competitive and efficient market it is necessary to establish zonal infrastructure charging that provides price signals for development of 'easy' and 'difficult' to serve sites. In relation to wastewater, regional WaSCs already have the evidence to identify such zones and this should allow the development of a market place to serve new developments, driven by the resilience requirements of the Drainage and Wastewater Management Planning Framework. A consequence of this approach could be price movements that exceed the 10% threshold, such a threshold should therefore follow the implementation of zonal charging, not precede them.

Bill stability will be enhanced if incumbent infrastructure investment is reduced as a result of more resilient local (full service) NAV solutions where these prove to be the best economic option. A market place for all large or difficult to serve sites, driven by the requirements of the Drainage and Wastewater Management Plan Framework, should encourage delivery of the most efficient solution, potentially contribute to sustainable local water resources and foster innovation.