Consultation on charging rules for new connections and new developments for English companies from April 2020

Severn Trent response

May 2019

WONDERFUL ON TAP

SEVERN TRENT

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 that there are opportunities to further improve the current new connections charging rules and mechanisms which the changes outlined within this consultation are looking to address.

The movement of the requisitions income offset against the infrastructure charge will ensure that all developer customers, including NAVs, will receive equal recognition of future income through customer bills (a level playing field), although we do note that NAVs already receive income offset against their bulk supply arrangements in the Severn Trent region. Likewise the removal of asset payments and the payment of full costs for requisitions work allows for clarity in requisitions charges and easier comparisons between incumbent water company charges and self lay provider charges which is important to promote effective competition within the contestable mains laying market.

We are mindful however that these changes will pose a number of challenges including the transitional arrangements, the alignment of two unrelated charging elements; the infrastructure charge and the requisitions income offset and the risk of change saturation within both new connections charging and the developer services market in general. We have volunteered our thoughts on the consequential areas to be mindful of at the end of this consultation response.

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.

[redacted]

Consultation on charging rules for new connections and new developments for English companies from April 2020

Q1 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 are broadly comfortable with the wording proposed and we understand why reference to income offset and asset payments have been moved out of the New Connection Charging Rules. However we believe that inserting key developer-related rules into the Charges Scheme Rules does mean that understanding developer-related items is now less straightforward for our customers and the trade bodies representing those customers. Developer customers and trade bodies now need to cross reference further documentation to completely understand the principles which apply, for example in rule 5m of the New Connection Charging Rules ""Infrastructure Charge" has the meaning given in the Charges Scheme Rules;".

We also note that rule 5b in the New Connection Charges Scheme Rules:

"*b) "Charging Arrangements" means a document setting out the charges, Income Offsets and Asset Payments, and/or the methodologies for calculating them those, applied by the water or sewerage undertaker in accordance with these rules*."

creates a risk that income offset information is not included in New Connections Charging Arrangement documents and it needs to be to ensure developer customers understand all charges and charging mechanisms which are involved in their schemes.

Q2 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.**

We welcome the proposal to introduce an information requirement on bill stability. We already publish a Statement of Significant changes for New Connections charges on our website which, for 2019/2020, highlighted and explained charges which rose by more than 5% in a single charging year. We also made our customers and trade bodies aware of our upcoming headline charges for 2019/2020 during the consultation sessions for this year's charges (including CCW). We do note however that bill stability for developer customers and maintaining a balance of charges between developer customers and other customers can be seen as separate assessments ie taking measures to ensure developer charges do not undergo unsavoury fluctuations in a single charging year could mean that developers do not pay for all costs incurred for developer work within that year and other customer bills contribute to these costs, over the course of a few years however the contributions will balance out.

We believe the 10% threshold is appropriate for developer charges given many of the services provided to developers by water companies are provided through contract partners who will apply inflation to contract rates each year. Inflation itself may cause charges for discrete services to increase by c3% in a given year therefore water companies will have c7% to cater for other cost increases such as material prices and salary increases.

For less discrete charges such as the infrastructure charge (five year rolling average based on investment on the network) the level of annual increases will be based on the profile of investment required in the coming years which is region and company specific and can be 'lumpy'. Water companies can take steps to ensure significant annual infrastructure charge increases are spread over incremental increases across a few years. However, this might either mean altering the investment profile by deferring important schemes or maintaining the investment profile and transitioning the infrastructure charge increases over a few years causing other customers to cover some of the short-term cost before balancing it out in the following years.

A final point of note on annual increases in charge, we believe that the changes in income offset will drive an impact on large developers and self lay providers specifically when it is implemented in 2020/2021 which is far greater than 10%. We have explained this point and the reasons for it within the 'additional comments' section of this response.

We welcome the information requirement of typical developments or packages. We have received feedback from our charges consultation sessions that water companies should publish consistent worked examples so easier comparisons of company charging frameworks can be made. Consistent development or package examples used to demonstrate annual increases would satisfy this feedback and also demonstrate the true (net) impact on each customer segment of making changes to the structure and value of charges.

We believe typical packages should include:

1) small customer or builder package

which includes the following elements:

- Standard single S45 connection (25 or 32mm diameter)
- Connection made in the highway which is less than 12m in length
- Simple traffic management (for example two way temporary traffic lights)

Whereby the following charges are payable

- Application fee
- Infrastructure charges (with income offset applied)
- Construction charges

2) large developer (water) package

which includes the following elements:

- New water mains (63mm) in PE
- Source of water (SOW) connection of the new mains to the existing network made in the highway
- Simple traffic management (for example two way temporary traffic lights)
- Length of mains pipework is 300m
- Number of new properties to be connected is 50
- Costs should be inclusive of all related items such as valves, hydrants and pressure tests

Whereby the following charges are payable over the full duration of the scheme (ie no charges are deferred for the purposes of the example):

- Application fee (including design costs)
- Infrastructure charges (with income offset applied)
- Construction charges for both mains and service connections

3) self lay provider (water) package

which is the same package as package 2 and includes the following elements:

- New water mains (63mm) in PE
- Source of water (SOW) connection of the new mains to the existing network made in the highway
- Simple traffic management (for example two way temporary traffic lights)
- Length of mains pipework is 300m
- Number of new properties to be connected is 50
- Costs should be inclusive of all related items such as valves, hydrants and pressure tests

Whereby the following charges are payable over the full duration of the scheme (ie no charges are deferred for the purposes of the example):

- Application fee (including design costs)
- Infrastructure charges (with income offset applied)
- Construction charges for both mains and service connections split by:
  - Work carried out by the self lay provider
  - Work carried out by the water company (non-contestable and contestable)

Additional comments

Whilst we understand the outcomes that these changes are aiming to achieve, we would like to raise a few points of note.

Firstly the infrastructure charge and the income offset applied against the requisitions charge have no relationship and therefore (as it will be in the Severn Trent area) the amount of income offset can outweigh the infrastructure charge. Across the total charges payable by customers throughout the process from application to connection the charges will outweigh the offset. However, as each charge is paid at different times the implication would be for Severn Trent to pay out to developers when the offset is applied against the infrastructure charge (a negative income).

The timing challenges are particularly relevant on new mains schemes where developers will be required to pay the full requisitions cost up front and receive the offset benefits later on in much smaller instalments and to a lesser amount (now that the offset is spread across more customers). This poses cash flow challenges during the first few years of implementation both for developers and self lay providers. We expect the impact of the changes to drive greater applications for new mains schemes in quarter four of this year as developers and self lay providers look to take advantage of the current income offset amounts or receive asset payments before the arrangements change.

In terms of the quantum of income offset honoured under the changes it would be helpful to have clarification on whether we should also be honouring the total value of asset payments too. In the worked example in the decision document from November 2017 it makes reference to honouring the total value of income offset but dividing over the total number of connections rather than simply the requisitions connections. Currently the asset payments are equivalent to the income offset benefits on self lay requisitions sites and therefore it seems logical that the total value of asset payments and income offset be divided over all new connections rather than simply the income offset which only apples to a proportion of our mains schemes.

If our interpretation is correct, the same total value will be spread over more connections. Developers and self-lay providers that currently receive the benefit of the income offset or asset value payments will get less. If they understand the implications of the changes, this will provide a further incentive to submit applications before the arrangements change.

When reporting incidence effects year on year, this change is likely to drive increases considerably above the 10% threshold for the large developers and self lay (packages 2 and 3 per our categories above), with reductions for category 1.

Our final point relates to the amount of change currently experienced by the developer services market and the timing of related items. The developer services market has seen significant changes across a range of topics in recent years and, whilst all of these changes are looking to achieve the right outcomes, the volume of change can create a risk of saturation for our customers, trade bodies and internally for our teams who need to guide our customers through.

We do have a concern that making the income offset changes only two years later than introducing the New Connection Charges Rules makes it harder to embed and assess the impact of the new rules. We will have many customers who have many ongoing schemes which were each started over multiple years and even some where different stages of the same scheme may fall into a different charging framework (pre 2018, 2018 to 2020 and post 2020) and in these circumstances they will have a complicated arrangement of charging mechanisms to understand and budget for.

Likewise we are currently awaiting a secondary consultation on New Connection Charges Rules for Welsh companies and we are concerned that the confirmation of the final rules will not leave sufficient time to plan, consult on and assure charges for 20/21 when the rules are due to be implemented. This also poses a risk to the developer services element of our Hafren Dyfrdwy PR19 plan which has been populated on the basis of the current charging legislation. The FD due date is currently planned for quarter three of this charging year which puts pressure on the date for confirming final Welsh rules.