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Strategy & Regulation

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28 May 2019

Dear [REDACTED],

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

We welcome the opportunity to respond to this consultation, which we consider to be in the interest of supporting the continued improvement in the developer service market. We are largely in agreement with the changes proposed by Ofwat regarding the treatment of income offsets. We also consider the proposed changes to the corresponding Charges Scheme Rules and New Connection Rules to be clear and reasonable. Our answers to the questions posed are followed by some general comments.

Q1. Do you have any comments on the proposed wording for the New Connection Rules and Charges Scheme Rules which will come into effect from April 2020?

We are largely in agreement with the proposed wording for the New Connection Rules and Charges Scheme Rules. We have already taken steps to address the proposed change to the treatment of income offsets. We are positive about the contribution the change in treatment of income offsets will have on levelling the playing field in the provision of developer services.

We do, however have comments regarding Rule 19 and Rule 32.

Rule 19 on balance of charges.

The rule states:

*“In setting charges in accordance with the present rules, undertakers should take reasonable steps to ensure that the balance between contributions to costs by Developers and other customers prior to 1 April 2018, is broadly maintained.”*

We understand and agree with Rule 19, which is consistent with the Defra Charging Guidance<sup>1</sup>. However, in order that we can maintain this balance when the new treatment of income offsets comes into effect, we will need to continue to offer discounts of a comparable value. In doing so, it is more than likely our infrastructure charges will end up in a credit position, as the value of the

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<sup>1</sup> Charging guidance to Ofwat January 2016

discounts offered is expected to exceed the revenue recovered through water infrastructure charges.

We note that in Ofwat's Draft Determination response to United Utilities<sup>2</sup> it states:

*"Six companies (including all 3 fast track companies) are forecasting a negative infrastructure charge as the income offset is greater in absolute terms than the infrastructure charge. In 2020 new charging rules for developer services (England only) mean that the income offset is now applied to the infrastructure charge. We said in Charging Rules for New Connection Services (December 2018) that in the transition to the new charges regime, that companies should take reasonable steps to ensure that the existing balance of charges between developers and other customers prior to the implementation of the new rules should be broadly maintained.*

***For the purposes of determining an appropriate industry position, we have capped the amount of income offset such that it cannot exceed the infrastructure charge for the 6 companies referred to above. This is because we do not recognise this as being consistent with the balance of charges under the pre-2020 regime"***

We do not feel that implementing the cap on income offset discounts is consistent with our obligation to comply with Rule 19 to maintain the balance of charges between Developers and other customers.

To illustrate the impact if this cap is applied within Thames's region there would be an increase in the overall charges levied from Developers by c £36m over AMP 7. This equates to an average £170 increase in the overall cost per connected property.

We believe that further consideration should be given to this inconsistency between the Charging Rules and the Draft Determinations. It is our view that the charging rules accurately reflect the intent of the Charging Guidelines and that the infrastructure charge cap introduced in the Draft determinations should be removed

### Rule 32

The text of the final sentence of Rule 32 states that "Any such justification must be clearly identified in any Charging Arrangements prepared pursuant to these rules". We suggest that this should be changed to "Any such justification must be clearly identified in any Charges Schemes prepared pursuant to these rules".

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?

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<sup>2</sup> PR19 draft determinations: United Utilities – Securing cost efficiency actions and interventions

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 understand the need to balance each of Defra's charging principles when creating and updating charging schemes and we consider that Defra's requirements in this regard for Developers are clear.

*"It is important that developers are able to plan the costs of development with confidence. Charging rules should encourage consistency in the approach to charging for connections or adoption of infrastructure. Information on the types of charges that can apply and what these charges can consist of should be made accessible to developers. Where there is a need to adjust charges to make them more cost reflective this should be managed such that it is clear and does not impact on competitiveness."*<sup>3</sup>

The specific requirement to monitor year on year price changes is not included in the guidance for Developer charges, and appears only in the Water and Sewerage section of the guidance: *"the Government expects Ofwat to take action to ensure that any changes in the charges faced by customers from year-to-year (where water usage does not change markedly) are proportionate and reflect the Government's overarching policy objectives for the sector."*<sup>4</sup>

We believe that extending an approach intended for Water and Sewerage charges to Developer services is not justifiable or workable. Following are three specific examples which we believe illustrate that applying the proposed 10% limit for significant bill increases to Developer services is not practical at this time.

#### **Example 1. Waste Water connections**

Thames Water has previously advised that Waste New Connections prices may be subject to significant fluctuations year on year. This is because most waste connections are carried out by the Developer and then subsequently adopted by Thames Water under a S104 agreement. The jobs delivered by Thames Water are generally the more complex jobs that Developers are unable or unwilling to carry to out. These are, therefore, very low in volume but very complex so cost can vary considerably and an arbitrary limit on bill increases would not be practical.

#### **Example 2. Impact of competition on incumbents' pricing**

The nature of the requirement for fixed charges for water and waste connection and requisition activities by incumbent companies effectively means that an equally efficient competitor (NAV or Self Lay Provider ("SLP")) could win half of the work from us on the basis of price. If companies are successful in doing this, the costs the incumbent incurs are higher per job on the jobs that we do, and each year the fixed prices would need to ratchet up as competitors are successful.

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<sup>3</sup> Section 8.11 Defra charging guidelines 2016

<sup>4</sup> Section 2.10 ibid

We feel coping strategies for price increases which are driven by the success of our competitors are not required.

### ***Example 3. Need for transitional arrangements***

We recognise that the introduction of these revised charging rules will have significant impact on certain customer groups. This is complicated further by the need for transition arrangements for inflight schemes already commenced under the old charging rules. We therefore believe that if this requirement is deemed necessary, that it should be commenced from April 2021 onwards.

We therefore suggest that the 10% limit for significant bill increases is not appropriate, particularly for 2020 and should not be applied.

### **General**

We do have a concern about the support from customers regarding the timing and cash flow impact of the implementation of these rules and have a comment on D-MeX.

### **Customer support**

We are concerned that the new rules will adversely affect the cash flow of Developers who will have to pay, in full, for the new main (whether delivered by a SLP, a NAV or an incumbent). This will be partially offset later in the project when infrastructure charges and credits are applied. This will particularly impact the medium size developer for whom we know costs and cash flow are key drivers. Larger developers are likely to be able to factor this into their projects and small/ individual homeowners will be better or no worse off. We have been raising awareness of the planned changes over the last two years whenever we have held events with SLPs and Developers but there is not widespread awareness of this change. We are keen to see that support from Developers and their trade associations is confirmed prior to these rules being introduced.

### **D-MeX**

We would like to make an observation regarding D-Mex. In addition to the implementation of these charging rules we will be implementing the Water and Waste Codes for adoptions and the PR19 determination between now and April 2020. Given that all of these changes interact to a certain extent with each other, there is the risk of a potential adverse impact on D-MeX with an associated cost impact to Thames.

As these charging rules do not apply to the Welsh water companies, their customers will not be subject to this change. We suggest that either an allowance is made on D-MeX measures for non-Welsh companies or that the comparisons are made purely on those companies operating under the English regime.

We look forward to discussing these matters at our charging meeting planned for 17 June 2019.

Yours sincerely,

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