

Compliance with competition law and charging rules obligations with respect to the self-lay market for new connections

Summary

We take our obligations under competition law very seriously and fully understand the important role we play in ensuring the effective operation and development of competitive markets for developer services.

We have reviewed our policies and practices in light of potential issues raised in the letter and conclude that we are compliant with competition law and charging rules obligations with respect to the self-lay market for new connections. However, we recognise that some self-lay providers (“SLPs”) now actively offer design services to developers and that our current charges scheme does not allow for this. We will introduce separate charges for design costs as part of our 2020-21 charges scheme and are currently reviewing with our customers the best way to implement.

Promotion and engagement

For some years now, we have been actively promoting choice to developers in our area for new connections and delivery of on-site infrastructure. Through closely working with developers and SLPs, we have seen a significant increase in the number of self-lay applications we receive.

We are continuing this engagement to understand how we can deliver better services to developers and SLPs. We have implemented numerous improvements to our self-lay process over the past three years and continue to make changes. Feedback from SLPs has been positive, for example [REDACTED] from Fair Water Connections in September 2017 said: ‘Thanks for giving me the leaflets Thames Water has produced relating to self-lay promotion – I really think that they are spot on.’

We have built up a dedicated self-lay team who work closely with our SLPs. We hold bi-annual forums and send out monthly newsletters as we seek to continually improve our service to SLPs. At the 12 July 2018 SLP forum, 40% & 27% said we were easier than most and the easiest respectively to deal with compared to other water companies. We look forward to making further improvements, with our current focus on Code of Adoptions consultations.

Competition Law training

Regarding competition law compliance we take our responsibilities very seriously and deliver annual face to face competition training with our Legal department to those in high risk roles. Last year, we launched an e-learning competition training course so that everyone in Developer Services could refresh their understanding of this area.

Current and prior year charging – transparency and engagement

We agree that to promote competition for contestable work, charges should be published in a clear and accessible manner. Our new connection charges can be found on our website¹. Contestable and non-contestable charges are identifiable by ^C and ^{NC} throughout the document and we explain what services are included in our fixed charges. We have received positive

¹ <https://developers.thameswater.co.uk/>

feedback from various stakeholders on our new connection charges, including recognition from Ofwat in its January 2019 report².

We consulted extensively when developing these charges, as detailed in our assurance statements which can also be found on our website. We engaged with customers, CC Water ("CCW") and our Customer Challenge Group and held an engagement day with SLPs in November 2017 and with large-scale developers and consultants in January 2018.

Feedback from this engagement has been positive, as following examples show:

- April 2018 Developer Scrutiny Panel told us our engagement on charging "hit the mark" and was "best in the bunch"
- July 2018 SLP forum, 82% of audience said our 2018-2019 charging arrangements were better than previous arrangements
- October 2018, Ofwat fed back that no major changes were required
- CCW asked for clearer messaging when we request further payment from customers, which we reflected in our 2019-2020 charging arrangements
- October 2018 Developer Scrutiny Panel had no objections to our proposed approach for 2019-2020 charges
- November 2018 meeting with the Home Builders Federation ("HBF") agreed our charges were transparent and will continue to collaborate with us on future consultations
- December 2018, [REDACTED] from HBF praised Developer Services for the 'seismic' improvements we have made in communicating with developers.

Current and prior year – assurance and cost reflectiveness

We followed rigorous assurance for 2018-19 and 2019-20 new connection charges, as outlined by our assurance statements, which included sign-off from Thames Water Utilities Limited Board.

For 2018-19, KPMG reviewed our charging methodology and provided confidence to the Board that our charges complied with the Rules and that reasonable steps had been taken to ensure charges were cost-reflective. The same cost models were used in setting 2019-20 charges and reviewed by Thames Water Internal Audit to ensure charges remain in line with the Rules and that reasonable steps were taken to ensure charges were cost-reflective.

For both years, we have undertaken a review with our legal team and Charging Arrangements have been developed considering competition law. In particular, consistent principles and approaches have been applied to the calculation of charges and when they are payable for different classes of customer. Charges (including any income offsets), asset payments and arrangements for when they are each payable, have been set in accordance with the principle that they should promote effective competition for contestable work.

Design fees

To date, SLPs have indicated that undertaking design is not a priority for them. We have therefore not developed separate charges for design services and these are reflected in our overall charges for mains requisitions. However, we understand that there are regional differences and in some company areas, SLPs actively offer design services to developers. As a result, we will introduce separate charges for design costs as part of our 2020-21 charges scheme. This is consistent with the response we gave to Ofwat on Request For Information on 25 Jan 2019.

² Company monitoring framework: 2018 assessment Individual company report Thames Water page 5

Income offset, asset payments and 2020 new charging

For water connections, we continue to calculate asset payments using the long-standing methodology, Discounted Aggregate Deficit (the “DAD” model). It is a well-established model and we considered the alternatives to be inappropriate. There is a DAD calculator on our website to help estimate the asset payment we'll make if a SLP lays a new water main or income offset we'll apply if a developer asks us to lay a new water main or new sewer.

Waste connections are almost entirely done by developers and as per extant charging guidance; we do not offer asset payments. In exceptional circumstances, we are required to make the connection ourselves which occurs less than 50 jobs per annum on overall base of 50,000 consented connections.

The new charging rules in April 2020 will remove income offsets and asset payments. We will ensure that we comply with the new charging rules and will continue to conduct extensive engagement with all our stakeholders, supported by rigorous assurance. We have already hosted a workshop with our developers, SLPs and NAVs stakeholders to outline our proposed charges and seek their views on how best to implement. [REDACTED] and [REDACTED] from Ofwat were at the workshop and found it extremely informative and useful.

Margins

Regarding the concern raised about available margins for SLPs when competing against the requisition charges of water companies to provide new connections, we believe we have followed the Ofwat guidance in the Charging Rules³, in particular, on allocation of overheads to ensure that all attributable costs are taken into consideration and all non-attributable costs are excluded.

³ Independent review of section 45 administration fee and overhead costs on behalf of the Water Services Regulation Authority (Ofwat) - summary, April 2014