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charging@ofwat.gov.uk

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Dear Ofwat

<u>Re: Consultation on updating Ofwat's charging rules</u>

Thank you for the opportunity to comment on this consultation.

We are broadly supportive of the changes proposed, which we agree will help to simplify the timetable and clarify the information to be provided to Developers. However, we have some comments and concerns which are detailed in our responses to the consultation questions:

Q1: Do you agree with our proposed rule changes? Please offer alternatives if you think they would better achieve our intentions.

<u>Charging Publication Dates</u>

We agree with the proposed changes. Using a defined date rather than a number of weeks provides greater clarity of the timetable which is useful for arranging assurance and approval meetings.

<u>Publishing Statements of Significant Change</u>

Our wholesale and customer charges are produced within an integrated model, and subject to integrated assurance and approval. For us it would be more logical for the publication date for statements of significant change to be aligned to the Wholesale Charges date, which would create a consolidated deadline for charges publications.

As currently proposed, the deadline for the wholesale charges would be the 13 January, but the statement of significant changes is 3 weeks prior to the 1st February, which is 11 January. We would prefer the statement of significant changes deadline to be aligned on 13 January, which would simplify assurance and governance arrangements. We do not consider that this difference of two days would have a material impact on customers, given that it relates to bills that they will receive at least a month later for unmeasured customers and 2 ½ months later for measured customers. In practice we publish simultaneously with charges schemes, because that suits our Board assurance and approval process and allows additional time for customers. We do not think the current arrangements prevent early publication of charges as we currently do.

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A further simplification not considered in the consultation would be to align the July notification of potential significant changes in wholesale charges to the indicative wholesale charges consultation date in October. This would allow more time to consider changes, as we currently believe the July deadline is too close to prior year annual reporting to assist tariff development, so it is difficult to provide a meaningful update at this point. Ofwat will have visibility of how useful the July statements have proved to be for Retailers, but our expectation is that the provision of the indicative charges and an explanatory statement three months ahead of the final publication date offers sufficient opportunity for Retailers to take any necessary actions.

The consultation suggests that there is efficiency in companies being able to simultaneously publish the statement alongside the charges scheme, particularly where there are no changes. We agree that would be the case, but in this situation would suggest the efficiency only comes from being able to simultaneously publish the statement on the charges scheme publication deadline (1 February). We do not think this would have an adverse impact on customers, as where there are changes to report those would be announced on 13 January.

Cost Reflectivity

We agree that it is reasonable that New Connection Charging structures should reflect long run costs, for consistency with existing principles.

Consistent terminology

We will include the proposed terminology definitions within our next update letter to SLPs and Developers, and feedback any suggestions they may make.

Worked Examples

We agree that the inclusion of worked examples has been helpful to Developers and SLPs. Our own charges scheme includes the consistent examples agreed at industry level, as well as additional examples which we believe to be particular helpful in our area. It was particularly useful in explaining the basis of income offset and engaging with SLPs on the changes over 2018-20. We are looking to further improve our presentation of these, following a review of industry best practice, including improved provision of diagrams.

Where to issue rules on infrastructure charges

We agree it is logical to move the infrastructure charging rules to the New Connection Charges Rules.

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Income offset and connecting to existing mains

We have no objection to allowing the option to apply income offset payments to existing mains where it is appropriate to do so.

Network reinforcement and NAVs

We agree with the logic in the proposal to consider the impact on reinforcement costs for neighbouring companies (NAVs). The rule should for avoidance of doubt be clear this only applies to network reinforcement by the incumbent undertaker, not by the NAV or another undertaker. We believe this is the intention from the consultation. This will allow network reinforcement to consider the impact on costs up to the point of the company boundary with the NAV contingent with its area of supply. There may be circumstances that a NAV site requires network reinforcement from more than one company – the principle should allow for such unusual circumstances.

Quotes spanning different charging years

We agree it is helpful to set out the validity of quotes within the new connections charges document, we already do this within the quotes that we send but can add to our new connections charges scheme.

Q2: Do you agree with our proposed changes in Appendices 1, 2 and 3?

Our comments on these are addressed above.

Q3: We seek your views on our clarification of the five-year rule. In particular, we would like to know of any potential implications for charges and customers' bills from companies following our interpretation.

We are satisfied with the clarification provided, but are concerned that it introduces new uncertainty and variability for customers which may or may not be Ofwat's intention. This appears to be consistent with our approach to setting infrastructure charges, which is on a five-year forward looking basis, but it is also necessary to take into account the balance carried forward of any over or under recovery. It would be preferred if Ofwat clarified this point. We believe this is the correct interpretation of *"If there a difference between expenditure and receipts in one year, customers will want to understand the reasons behind it and want assurance the imbalance will be corrected in future years."*. The only way of correcting the imbalance, is to take it into account looking at the five-year expected costs and properties. The

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reason why this must be the case should be clear – if there is a major scheme where expenditure takes place in March of a year rather than April, at year end and for future charges there will be a different level of spend, even for the same number of properties being corrected.

The alternative could be unexpected changes in the level of infrastructure charges. The DSRA is not in our view relevant to these circumstances – because this is not based on company investment plans but on Ofwat's view of property numbers at price setting. In any case, companies could not anticipate the DSRA methodology when designing their approach to infrastructure charge recovery prior to its development during 2019. Maintaining the balance of charges to developers (as per DEFRA's guidance to Ofwat and the sector) means that if infrastructure charges are not smoothed out for balances brought forward when calculating the five year forecast, it merely causes an opposite variation in income offset.

We hope these responses are helpful, as ever please do let us know if you would like to discuss further.

Yours Sincerely

James Holman
Head of Economic Regulation