



Charging Rules Consultation – June 2021

Southern Water Response

Thank you for the opportunity to respond to your consultation on updating Ofwat's charging rules. In general, we support all of the proposed rule changes. Where we have comments or minor proposed amendments, we have included this in the specific consultation questions below.

Consultation

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

Change to a fixed publication date

Yes, we believe that this is a reasonable proposal and agree with the fixed publication dates proposed.

Publishing statement of significant change

We agree with this proposal to allow simultaneous early publication of the charges scheme together with the publication of the statement of significant changes, where there are no significant changes to report.

New Connections Cost Reflectivity Principle

We agree that charges should be cost reflective. As we have stated in previous consultation responses we strongly believe this should be based on the costs we incur through a competitively tendered contract. To require companies to ensure cost reflectivity at the level of their contractors' costs is likely to result in the need for significant re-negotiation of existing contracts across the sector and potentially the need to separate developer contracts, with the consequent loss of scale and scope economies. We have not seen an impact assessment of this proposal which demonstrates that the benefits would outweigh these significant costs. We believe Ofwat need to carry out such an impact assessment before proceeding. We would suggest that a better approach would be for Ofwat to carry out comparative analysis of companies charge rates and use its powers to investigate where it identifies specific concerns or, alternatively, clarify that the principle of cost reflectivity applies to the costs incurred by the water company.

Please note that, although we recognise that infrastructure charges should be based on long run forecast costs for network reinforcement, it is not clear whether for new connection charges related to on-site assets, there is any practical difference between short and long run costs. We would welcome clarification of whether Ofwat believes there is a difference in respect of on-site costs.

Consistent Terminology

We agree that the use of consistent new connection terminology developed by WaterUK should be a best practice requirement.

Worked Examples

We agree with the detailed information requirements of the worked examples, which appear similar to the current examples we provide.

Migration of Infrastructure Charges

We agree that the rules relating to infrastructure charges should be moved into new connection charging rules from the Charges Scheme rules.

Income Offset Definition

We fully support the clarification of the definition to include connections to new and existing mains.

Network reinforcement

We fully support the proposal to amend the definition of "network reinforcement" to include reinforcement costs incurred by bulk service NAVs connections as well as connections within area of appointment.

Quotes spanning charge periods

We support the proposed new rule that requires companies to set out in their transitional Charging Arrangements. We currently include transitional arrangements in our new connection charging document.

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

We support the proposed changes in Appendices 1 and 3.

Our only comment is regarding Appendix 3 A2 (a) vi. which states 'itemised unit costs for all relevant services' for which we have interpreted as unit charge. We would not expect to publish our unit costs.

We have comments on 'Appendix 2 proposed new and amended terms' which includes changes to the originally agreed terms and the removal of worked examples, which we will feed back via the WaterUK working group.

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 have concerns regarding the clarification of how the five year rule should be applied to the calculation of infrastructure charges.

Our interpretation of the five-year rule was to set our infrastructure charge based on both retrospective consideration of actual costs and forecasts of likely costs and revenue. This interpretation was based on the rule that charges should "cover the costs of Network Reinforcement that the relevant undertaker reasonably incurs." The clarification proposed would require the charges to be based wholly on forecast costs, rather than costs incurred. This would require a change to the

rule to state that charges should “cover the costs of Network Reinforcement that the relevant undertaker reasonably *expects to incur*” rather than a clarification of interpretation.

We also have concerns that the proposed clarification to calculate charges wholly on forecast costs would negate the principle of cost causation for developers to pay for the offsite costs of network reinforcement in full. Should the forecast costs be inaccurate, any impact on revenue will result in changes to end-customer charges and revenue, as there is no specific Developer Services Revenue Adjustment mechanism to address over- or under-recovery against network reinforcement costs.

We do not yet know the implication of this change, but should it be implemented our infrastructure charge will be impacted. This could be significant and therefore we suggest a glide path is permitted should any increase be greater than 10%.

Should you have any queries on our response or would like to discuss further, please do not hesitate to contact me.

Yours sincerely,

[Redacted signature]

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