

9 June 2017

New Connection Services Charging

Water UK conclusions



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1. Introduction

- 1.1.** On 2 June 2017, Water UK published a document (“the Responses document”) setting out the outcome of the consultation it had conducted in relation to the implementation of the new Ofwat rules on charging for new connections services.
- 1.2.** Many respondents to the consultation were keen to see differences being minimised between the approaches that companies are going to adopt towards the implementation of the new rules.
- 1.3.** Water UK recognises the strength of this aspiration and considers that it would therefore be helpful for the organisation to publish its own interpretation of the conclusions that can be drawn from the consultation exercise.
- 1.4.** Water UK is not able to require its members to follow any particular course of action in implanting the new Ofwat rules. However, given the central role Water UK has played in the consultation exercise, water companies and others may find it helpful to understand the conclusions we believe can be drawn from the consultation.
- 1.5.** Ultimately, companies have the responsibility to ensure compliance with Ofwat’s rules and with the general requirements of competition law. Nothing in these conclusions is intended to reduce or remove that responsibility.

2. Exceptions from the requirement to publish fixed upfront charges

2.1. Compliance with Ofwat's rule on the provision of fixed upfront charges (assuming that it will allow for exceptions in line with the recent consultation) requires companies to provide either fixed charges or charging information that will allow developers to work out for themselves a good approximation of the costs of work that a project entails. Companies will however be able to state that such advance information will not apply in certain cases. This will need further definition but examples could include circumstances where:

- available data is insufficient to provide a reasonable estimate of costs (this is intended to cover both cases where a company has not done a similar job in the past or the ground conditions are outside the parameters that contractors' rates cover)
- where a project crosses or is adjacent to other utilities' infrastructure and their consent is required for the works
- the project affects land subject to special rights (eg, Crown land, SSSIs).

2.2. We note the concern expressed by Reckon in paragraph 6.1.2 of the Responses document about the competition implications of publishing detailed information about fixed

charges for different elements of work. Provided these costs are published independently by companies and there is no "price signalling" involved, we would not expect this to present an obstacle to the publication of such information.

- 2.3.** Water UK will give further guidance on this topic with a view to reaching a common understanding on circumstances in which it may be reasonable not to offer a fixed upfront quotation.

3. Dealing with income offsets/asset payments

- 3.1.** We deal below with the suggestions from Reckon about the way in which the treatment of income offsets/asset payments could be handled. It appears that most companies, at least in the immediate future, will continue to offer such offsets but there are cogent economic arguments against the principle of offsets, particularly in circumstances where overall charges income is fixed. The removal of income offsets would also substantially simplify the calculation of charges.
- 3.2.** Calculations by some companies suggest that it would be relatively straightforward for them to remove offsets, possibly moving to the use of a balancing payment/discount to comply with the overall balance requirement of Ofwat's Rule 19. Some companies may therefore not pursue the suggestions made by Reckon in this regard. It may be helpful for there to be a public debate about the merits of the income offset principle and Water UK will consider this further with members if, as seems likely, some propose moving away from offering offsets.
- 3.3.** Where companies are proposing to retain offsets, we would encourage them to explore the methodology proposed by Reckon in paragraph 6.2.2 of the Responses document to calculate the available offset for properties on individual developments. This methodology would seem to allow the circumstances of the individual development to be taken into account and to allow publication of sufficient information to provide clarity about the quantum of the offset.
- 3.4.** While further work remains to be done to work out the details of the suggestion, we see considerable merit in the proposal in paragraph 6.2.3 of the Responses document to find a way to offer offsets to NAVs. This would help to meet long-standing criticism from NAVs that the current system works unfairly against them and may be in breach of competition law. The conclusions of Ofwat's study into the NAV market may also inform companies' approaches to this question.
- 3.5.** More broadly, the simplicity offered by a system in which offsets/payments are offered to all connections, however those may be effected, has much to recommend it. While this is not explicitly provided for by Ofwat's rules, there are potentially ways to introduce such payments without contravening the rules. We would welcome further clarification from Ofwat on this issue.
- 3.6.** The debate about the true purpose of the offset principle is an interesting one but should not in our view stand in the way of an approach which will allow those companies

proposing to offer offsets to level the playing field for all those connecting to companies' networks.

4. Infrastructure Charges

- 4.1.** In the first edition of charging schemes under the new rules, we think it unlikely that companies will have sufficient data to provide the variable infrastructure charges recommended by Reckon. We are also conscious that the complexity and resource intensive nature of the current calculation of reinforcement costs is one of the major problems that the new charging regime is seeking to overcome. The difficulty faced by smaller companies in particular in dealing with significant one-off reinforcements should also be acknowledged.
- 4.2.** We are therefore wary of introducing new systems which replicate the complexities of the old system. The economic justification for a more "site-sensitive" charge is clear, but it would be desirable to have evidence that any more complex regime would have the intended effects, e.g. encouragement of water saving. It may therefore be appropriate for a simpler approach to be adopted initially and for companies to investigate more sophisticated approaches in the coming years.
- 4.3.** The zonal charge concept also will need to demonstrate that it can achieve the aspirations of its promoters, helping to direct development to areas well-served by infrastructure and imposing higher costs on developments which are expensive to serve.

5. Maintaining the balance

- 5.1.** We note in particular the comment by Reckon in the Responses document that Ofwat could have but did not require companies to take all steps necessary to preserve the balance of charges between developers and other customers. As Reckon point out, an absolute requirement to that effect could have undesirable consequences. We therefore consider that companies have some freedom as to how to demonstrate that they have taken "reasonable steps" to achieve that balance, perhaps using one of the three approaches suggested by Reckon in section 6.4 of the Responses document.

6. Achieving commonality between companies

- 6.1.** Water UK is committed to preparing and publishing a template quotation form, building on the work that has been done to date within the working group. Mike Harding of IWNL has agreed to lead a sub-group to prepare both such a form and a model-form charging scheme. This will be presented to the Water UK Council for its endorsement.
- 6.2.** We are aware that at present, the template may not be capable of being implemented by all companies because of the system changes that would be needed to accommodate such a form. However, given the strength of views in favour of such an approach, we believe that this should be an express aspiration on the part of companies and that it would be helpful if each company were to make public a timescale by which they would plan to adopt such an approach.

7. Defining contestability

7.1. Water UK will be establishing a sub-group under the leadership of Iain Amis of Anglian Water to consider further the definition of contestable work and will work with stakeholders to have an agreed approach to this topic. Water UK considers that the output of this group should then be adopted by all companies as there is no obvious reason for variations between companies' approaches to this topic.

8. Planning principles

8.1. Water UK will be asking all of its members to publish and adhere to the standards set out in the planning principles set out in the consultation. Only minor amendments were proposed in response to the consultation. The new charging regime may provide an opportunity for changes to the principles, recognising the new certainty that companies have as to the funding of network reinforcements and this will be the subject of further dialogue with interested stakeholders.

9. Modelling parameters

9.1. Water UK expects that all companies will publish their modelling parameters, both for waste water and water supplies as part of their charging schemes. The former parameters are ready for publication but those for water supply need some further work. We will aim to progress this before April 2018.

10. Test data

10.1. As part of the consultation, Water UK developed a series of spreadsheets for each water company to compare proposed and existing charges for a range of development scenarios. There was wide support for their use to provide a consistent framework for comparisons of 'before' and 'after'. Water UK would therefore encourage companies to adopt this approach when consulting with their stakeholders on their proposed charging schemes.

11. Transitional arrangements

11.1. The consultation exercise revealed stakeholder support for the adoption by water companies of common transitional arrangements. These will need to allow customers a reasonable time to adjust to the new charges and deal fairly with development proposals that are currently 'in the system' to minimise the risk of 'price-shocks'. Water UK will initiate work to produce proposals for consideration by stakeholders.

12. Other issues

13. Water UK recommends that the conclusions in the Responses document on point of connection, apportioning costs for additional capacity and funding of terminal pumping stations be incorporated into the charging scheme template referred to at point 6 above.