



# Fair Water Connections

An association seeking a fair deal in water supply provision

## **Response to Ofwat Consultation on Charging Rules for New Connections and New Developments for English Companies from April 2020**

This response is submitted on behalf of Fair Water Connections (FWC) which is an association which supports Self-Lay Providers operating across England and Wales. Our assessment is that currently over half of the water connections provided through self-lay across England are being done by SLPs who are members of FWC.

### Section A – General Commentary

#### A1. Introduction and Overview

The intention of Ofwat to re-allocate, from April 2020, the ‘income offset’ component on new mains provided for domestic purposes to defray Infrastructure Charges has been well signalled and the change made widely known across the self-lay community. So whilst SLPs have historically used the asset payment (which is derived from the ‘income offset’) to largely fund the mains they provide to developers many have already experienced the proposed national approach in Yorkshire Water (which made the change in 2018) and, to a large extent, in Wessex Water (who currently only offer a 15% allowance). Feedback from SLPs working in the Yorkshire is that they find the charging arrangements in much simpler to compete against company provision but the different financial terms take a while to explain to developers. (Feedback from Wessex is more mixed as there is much disquiet around how their current 15% allowance is derived. However the principle, in the Wessex region, of SLPs having to invoice developers is now reasonably well established).

Whilst FWC favours the proposed change regarding ‘income offset’ allocation it cannot endorse the proposals until Ofwat clarifies that it will not adversely impact on the amounts that developer customers pay, i.e. that company charging will maintain the ‘broad balance’ test required by the Ofwat Connection Charging Rules. This being put in doubt by the ‘income offset’ amounts of some companies exceeding their Infrastructure Charges. So, to maintain the required ‘balance’, these companies Infrastructure Charges would have to be set be a negative amount and would therefore generate customer refunds. We have however been told by a water company source that this is contrary to the PR19 instructions to companies. Hence we urgently require clarification that companies will not be restricted from redistributing their full current ‘income offset’ amounts directly off their Infrastructure Charges before we can countenance endorsing the current Ofwat proposals.

Should implementation go ahead we recognise that, for this to be successful, it relies on water companies doing much to explain the situation to their developer customers. Sadly, in this regard, many companies are nowhere near ‘best practice’ in their developer customer engagement and Ofwat is asked to ensure that, where needed, this is addressed by companies well before the February 2020 announcements of the 2020-21 charges.

Whilst there is still scope for improvement the publication of local, company specific, charging arrangements has benefited customers, and the SLPs who seek to support them. There is however much customer scepticism that the requirements of Charging Rule Paragraph 19, namely that the amounts customers pay should be broadly aligned with pre-April 2018 payments, are being honoured. This is because there has been no demonstration (other than some very generalised wording) of companies actually demonstrating how they have set about maintaining this 'balance'. So what customers sense is that they are generally now paying more with one company, in their 2018-19 Board Assurance Statement, being brazen enough to state "we have set charges to increase the amount of overhead costs recovered from developers. This will mean a change in the present balance of charges". (Rather than challenge this statement Ofwat has, in their 2018-19 Company Monitoring Framework, endorsed specific charges being increased without any apparent checks, in this company, that their 'overall balance' is being maintained!).

So we welcome the Ofwat intention to require much greater transparency around charging increases but, as discussed below, we do not feel that this goes far enough and propose further controls.

We also find it confusing to have connection charging matters detailed in both the Ofwat Charging Rules for New Connections and the Ofwat Charging Scheme Rules and urge Ofwat to combine everything relating to connection charging into a single document.

## **A2. Negative Infrastructure Charge Effect**

A consequence, having now seen both the post April 2018 company connection charges and their PR19 Developer Service activity submissions, of re-allocating 'income offsets' is that it should, in many cases, lead to Infrastructure Charges which need to be negative (i.e. companies will be giving refunds to customers rather than receiving payments). If this happens the impact of this, in terms of payment practicalities and the confusion this could cause customers merits being thought through before implementation decisions are finalised.

## **A3. Impact of Environmental Discounts**

Many companies have elected to offer Infrastructure Charge discounts as an inducement to developers for constructing lower water usage homes. Given the UK water situation this is both understandable, and commendable. What is however not clear in the Rules is how any such 'Infrastructure Charge discounts' should be funded, in particular whether such 'discounts' can be made up by other payers of the charge or should be sourced from companies (as they are the ones who thereby avoid the need to develop new water sources etc.).

Given the growing prevalence of this matter, and increasing uptake of the discount plus recognising that Infrastructure Charging will be materially changed by the proposed charging changes this matter merits now being specifically addressed in the Ofwat Charging Rules.

Furthermore, also see Section A7 below, we feel that if costs are being transferred onto other developer customers companies should justify the discounts they are giving. This is because feeding (or draining) all, even low water usage, developments will invariably cause some impact on the adjoining network yet many companies are giving full Infrastructure Charge discounts!

#### **A4. Payment Terms**

The timing of payments for water company provided works, in particular whether they are required in advance or on works commissioning (or offer Infrastructure Charge refunds early as a means to mitigate developers payments) will have a material impact on the ability of SLPs to compete against water company provision. Especially when companies can generally borrow money on much more favourable terms than SLPs. In this regard we do not consider that the provisions in Connection Charging Rule Paragraph 21 are sufficient (as this requirement relates to ‘charges’ and not how they are applied). Hence we call on Ofwat to introduce a further requirement that “terms offered must be set in accordance with the principle that they should promote effective competition for Contestable Work”

#### **A5. Payment Responsibilities**

Given that Infrastructure Charges are now clearly for funding works needed to get water to (or sewage from) a site, and not the new site specific network, it would clarify payment responsibilities if it was made clear that companies should always offer to bill developers directly (rather than via SLPs) for Infrastructure Charges. This being seen by our members as a means of better fulfilling Connection Charging Rule Paragraph 21 and thereby better promote effective competition.

#### **A6. Worked Examples**

Our membership views the provision of worked examples as paramount in them better understanding company charges. This is because it provides them with a means to identify, and deal with, any charging queries in advance of them meeting scheme specific deadlines.

It is therefore disappointing that not all companies have, to date, provided such costed worked examples and that, where costed scenarios, have been published they are all too often for relatively small developments and do not extend to the typical site scenarios that are of particular interest to SLPs.

We therefore propose that Connection Charging Rule Paragraph 12 be changed to make the provision of costed worked examples mandatory. Also that companies be tasked with providing costs against a prescribed set of typical development scenarios (which must extend to sites with upwards of 150 units).

*Note – we append a set of typical development scenarios we feel it is reasonable for all companies to, as worked examples, cost.*

We also note that many companies have difficulty demonstrating that they are funding any supplementary network enhancements, such as ‘additional’ cross connections and mains upsizing (to cater for future developments) out of Infrastructure Charge monies and not directly from customers, by way of site-specific charges. This will become more apparent when the full cost of site-specific works is directly charged to customers so making it clear, through worked examples, to company staff how such ‘enhancements’ should be handled is much needed.

#### **A7. Transparency in Infrastructure Charge Setting**

Although there is already a regulatory requirement for water companies, over a rolling 5 year horizon, to balance their ‘Network Reinforcement’ expenditure with their Infrastructure Charge

receipts there are very few examples of companies being open about either their (high level) budget or giving feedback on how they are doing. In a spirit of openness, and to minimise unforeseen charging adjustments as each 5 year period nears an end, we believe that companies should be tasked with providing their customers with an annual (high-level) budget and to annually report how well received income aligns with permitted expenditure.

Hence our view is that Ofwat now needs to enhance their requirements on Infrastructure Charge income and expenditure reporting and to make companies report both their budget and actual balance in ways that are made readily available to Developer Services customers.

We also believe that companies should be tasked with providing objective justifications of their reasoning when they (as is already the case with one company) set different Infrastructure Charges dependent on the nature of a development. This has not happened with the company who currently has an up to 5 unit charge, and larger development charge, and we feel that it is reasonable for them (and others who charge in this way) to fully justify why a significant charging variance reflects the different nature of work necessary to support each type of development. In our view the same justification requirement should apply should any company be permitted to effectively require new non-water saving premises to fund any network reinforcement needed to supply new 'water saving' premises.

#### **A8. Contestable and Non-Contestable Charging Elements**

Discussions with the Ofwat Market Outcomes and Enforcement team has highlighted that they do not fully appreciate how, in addition to necessary Network Enhancements, company charges for connection works and (more general) fees result in an array of non-contestable charge components on 'site specific' works. This lack of realisation that non-contestable elements always arise on 'site specific' works, and can significantly erode the proportion of total costs available to a SLP to fund their works, must distort how the competitive water connections impact is seen by the sector regulator. This probably leads to the simplistic view of the Ofwat Chief Executive (in a letter to us) saying "SLPs can target companies with higher charges" without any regard to the way that non-contestable charge elements adversely impact on the headline attractiveness of 'high charge companies'.

Also worthy of note is that some companies charge for activities at rates that are so low that it is difficult for SLPs to compete against. This leads to suspicions that such companies have structured their charges to deter competition (by having low contestable works rates but over recovering against non-contestable elements). Whilst Ofwat Connection Charging Rule Paragraph 21 should prevent this there is no evidence of Ofwat being alert to the issue, let alone testing how prevalent it is!

Further discussion on this matter, and the controls we feel are necessary, are discussed below.

#### **A9. Charging Elements and Bill Stability**

We welcome Ofwat's identification that there should be checks on companies arbitrarily increasing their prices. But before such controls are introduced we ask Ofwat to recognise that what developers, or those (such as SLPs) who provide services to them, actually pay comprises falls into a

number of discrete components. Primarily these are:-

- a) Infrastructure Charges;
- b) Site specific mains work, which is split between:-
  - (i) contestable; and,
  - (ii) non-contestable components (which include admin and overhead components);
- c) Service connection charges;
- d) Other services, such as pre-development enquiries.

So whilst supportive of a bill increase threshold (and setting this at 10% is not viewed as unreasonable) our members are very concerned that companies will seek to do this on a 'bundle' of all these charges and not at a charging component level. We regard this as being unacceptable and could lead to charging increases which deter competition going unchecked.

To illustrate particular concerns to SLPs situations can arise where the overall cost of site specific mains work is within the target threshold but where significant increases in the non-contestable components are masked by lower increases in the contestable work elements. This may arise just by companies passing on adjustments in their contractors rates (where their contractors make alterations, typically by increasing 'non-contestable' works costs, when they realise they are increasingly losing work to competitive providers).

Hence our view is that:-

- a) There should be no need to set a price increase threshold on Infrastructure Charges (as the rolling 5 year reporting should cover this); but,
- b) All of the other work type categories (including both 'non-contestable' and 'contestable' elements) should be separately tested to see whether they are within the increase threshold.

This should be done against the set of suggested (worked example) costed development scenarios we propose (see appendix below).

We also maintain that Ofwat need to be proactive where companies have charges that are significantly lower than the norm (across other companies) for the same activities. This is to ensure that predatory pricing is not being allowed to occur.

#### **A10. Transition Arrangements**

Whilst some small developments are relatively simple, with all the associated work connection completed within a single year many take much longer to build-out. Given that developers, and those (such as SLPs) who provide services to them will now have to cope with both 'site specific' and Infrastructure Charge terms which are derived from:-

- a) Earlier 'legacy' charges; or,
- b) Accepted prior to April 2018; or,
- c) Accepted during 2018-19; or,
- d) (Assuming changes from 2018-19) accepted during 2019-20; or,
- e) Accepted from April 2020

Plus have to handle modification and subsequent phases to sites in each of these we regard it as paramount that a clear framework is set-out by companies covering the transition of work falling across any of these charging basis categories. In our opinion this, and for subsequent annual updates, should be prescribed in the Ofwat Rules.

## **Section B – Consultation Responses**

### **B1. Statutory Consultation Response (Covering Proposed Changes to Charging Rules)**

Our view is that the proposed changes should only be made after Ofwat has demonstrated that they will permit the ‘broad balance’ requirement imbedded in the current Connection Charging Rules to be fully honoured.

If the proposals are subsequently implemented then wording changes (as discussed above) are needed to prescribe requirements on companies to:-

1. Publish, in their local charging arrangements, a rolling 5 year budget setting out their Infrastructure Charge income and expenditure returns/plans; and,
2. Clarify permissible means to fund any Infrastructure Charge discounts and to fully justify any differences in zonal, or type of development charges: and,
3. Deal with negative Infrastructure Charge payments amounts; and,
4. Ensure that payments terms/payment arrangements offered by companies do not adversely affect effective competition for Contestable Work; and,
5. Ensure that customers have choice as to who pays the Infrastructure Charges (rather than these being ‘bundled’ with the site specific charges); and,
6. Specify a range of site scenarios that all companies must cost as worked examples; and,
7. Formalise year on year transition arrangements

### **B2. Non-Statutory Consultation Response (Covering Bill Stability)**

As discussed in A7 above we welcome the introduction of a ‘significant bill increase’ threshold on connection charges but stress that, because of the split of work (in a functioning competitive market) between various parties the different components of a connections charge bill need to be separately considered. This is to avoid any cost increases which adversely affect competitive provision (such as on non-contestable works) going unchecked when they are countered by smaller increases/reductions on the contestable work components.

In our view, assuming that more transparency and openness around price setting is introduced, we feel that Infrastructure Charges themselves do not need to be incorporated into the new information requirements.

Subject to the bill components in each costed scenario (appended are our suggestions of development types needing to be covered) being adequately separated we would support the suggested 10% reporting threshold.

We do not, however, understand the Ofwat logic in making bill increase reporting stand apart from the Ofwat Charging Rule framework. We therefore urge Ofwat to reconsider this and make it mandatory, in the Charging Rules, for any significant bill increases to be reported as part of the annual publication of local charging arrangements.

**Section C – Follow Up**

Any questions/queries that arise from this response should be made to:-

[REDACTED]  
[REDACTED]  
[REDACTED]  
[REDACTED]

## **Section D - Appendix**

### **D1 – Proposed Prescribed Costing Scenarios**

Our view is that all (non-small) companies should be tasked with costing the following types of development scenarios (for both water supply and waste water).

1. Connection to a single new residential property
  - to an existing network in the highway outside their property (possible both 'short' and 'long'/road crossing connections needing to be considered);
2. Connection to a new flat type development of some 20 residential units
  - typically a large diameter water connection and a single sewerage connection into networks in the adjacent highway (possibly both 'long' and short' needing to be considered);
3. Conversion of an existing house into a new flat type development of some 20 units
  - costed as per Scenario 2;
4. Multiple connection to a row of 10 new residential properties
  - all supplied separately off existing networks (with a 50/50 split between 'long' and 'short' connections);
5. Small scale development of 20 new residential premises all requiring site specific works (mains and sewers) and able to be connected to existing networks (with road crossings) in neighbouring highways;
6. Small scale development of 20 new non-household premises, but with domestic water usage, each with just a general use sink and a toilet with a hand washing sink all requiring site specific works (mains and sewers) and able to be connected to existing networks (with road crossings) in neighbouring highways. [Note this scenario is specifically to show the handling of relevant multipliers];
7. Larger scale site development with 150 new residential premises all requiring site specific works (mains and sewers) each needing 100m of off-site connecting highway works;
8. Much larger development of 600 new residential premises to be built out in 4 discrete phases. All requiring site specific works (mains and sewers) each needing 200m of off-site connecting highway works.

#### Notes:

1. There should also be a requirement to cost both Scenarios 7 and 8 for NAV provision, i.e. not cover the site specific works but costs associated with the provision of a site boundary bulk supply (for both water and waste).
2. When companies offer different Infrastructure Charges these will need to be added to the costed scenarios.
3. If accepted each of the scenarios will need further definition so that there is consistent pricing.
4. Decision will need to be taken as to whether only current charges are published (as, on site work, it is possible for previous Infrastructure Charges to result in different total costs).