



# Fair Water Connections

An association seeking a fair deal in water supply provision

## **Input into Ofwat Consideration Around Ensuring Companies Actions are Developing Effective Competitive Water Connections Markets**

October 2019

### 1. Rationale for Submission

Whilst the letter, dated 16 September 2019, from Ofwat to company Chief Executives is geared towards companies providing a response we believe that it is appropriate for Fair Water Connections to provide input, based on the experiences of our SLP members, to whatever review Ofwat is planning to do once they receive the various company returns. Hence this submission.

The input we provide below covers matters a group of our members (on 9 October 2019) discussed with 4 from Ofwat whose primary roles are on market outcomes and enforcement. We felt that this meeting provided a good opportunity for our members, whose activities covered all water company areas, to share their experiences and the issues they routinely encounter which constrain the market for competitive water connection provision. This document therefore enables the various matters which were discussed at that meeting to be formally submitted to Ofwat for consideration.

Although we regard the general lack of the relevant information necessary to support self-lay provision, plus the absence of cross company standardisation and failure to commit to guarantee delivery of company provided works (or move in this direction by providing appropriate redress) as materially holding back self-lay we have separately made comments about these factors in relation to the latest water adoption proposals. Hence we are not further discussing these matters in this submission.

### 2. Dismay at Markedly Different Competitive Provision Levels

Providing new water supplies through Self-Lay has now been a statutory offering for 15 years and, for competition compliance reasons, should have been offered by water companies earlier than this. It is therefore extremely disappointing that currently:-

- only one company (United Utilities) looks to be in a position where they can argue that competitive provision market saturation exists (other than on small sites, which are not as cost effective for SLPs to service, or on individual connections which involve the significant costs of, non-statutory, street opening work); and,
- just a further 5 companies can demonstrate significant self-lay take-up (but are still a way behind the volume of competitively provided connections in United Utilities). In this category we place Anglian, Bristol, Severn Trent, South Staffs and Thames; and,
- that competitive connection provision elsewhere, whilst slowly growing, is so low that competitive provision market penetration can be classified as still at an insignificant level in many of the companies who fall in this category.

We discuss below the many factors which we believe materially influence this situation and which leads us to label the way many companies behave as merely 'tolerating' competitive water connection provision rather than 'embracing' a market geared around reliably offering the sort of service and responsiveness sought by their developer customers. We also consider that some companies demonstrate abusive conduct towards water connections market competition and that it is now time for Ofwat to take action against a company, or companies, so that it is clear to all where behaviour needs to change.

### 3. Market Promotion and Consultation

We applaud those companies who routinely host engagement days with their customers and who demonstrate willingness to meet with ourselves as they work through market related issues. A few companies do this a number of times each year, and include charging matters in the discussion as, and when, appropriate. Others appear to only host engagement sessions when they feel the need to discuss charging and the remainder have no regular engagement or events whereby they can promote their market choice offering to their customers. We estimate that roughly a third of companies fall into are 'open and responsive, category with a further third hosting events at least annually. The remainder focusing their engagement through (usually somewhat late) consultations.

Our view is that, whilst there are exceptions, there is a direct correlation between those companies who have the highest competitively provided connections workload and those who do the most to engage with their customers.

Experience from 2017 (i.e. ahead of the new connection charging arrangement introduction) and now being repeated (i.e. ahead of the 2020 charging changes) is that many companies do not understand the Charging Rule requirement to ensure that:-

Changes to charges covered by the [Ofwat] rules should only be made after proportionate, timely and effective consultation with groups of persons likely to be significantly affected by the proposed Charging Arrangements (or their representatives).

This results in:-

- Last minute rushed consultation. (At the end of October 2019 we, as a representative of a group of persons likely to be significantly affected have only been contacted by around half of companies in relation to their 2020 charging proposals. So we now query how the others are still going to have time for meaningful consultations, and any subsequent engagement, before taking recommendations to their Boards next January); and,
- Trying to endorse the making of significant changes by a high level discussion about charging concepts without any talk on what the charges themselves are likely to be; and,
- The avoidance of discussion on actual charges with the reasoning that the rates are not yet known as new contracts are in the process of being negotiated.

Hence we consider that Ofwat needs to do much more to promote meaningful consultation and assess the quality of the engagement (rather than only test whether any consultation has happened). We therefore urge Ofwat to establish the dates when companies actually contact their customers regarding charging matters and whether they have held 2 stage consultations.

In our view best practice arises when companies have an early discussion around their proposed direction of travel over envisaged charging changes and then, subsequently, test out customer

acceptance to their detailed proposals. This method of working is already operated by some companies (but clearly there is not now time to do this this year for the sizeable group of companies who have yet to initiate any engagement over their 2020/21 charges!).

#### 4. Engagement With Companies After The Ofwat (Emma Kelso) RD Letter on 29 April 2019

Having referred cases featuring the 3 charging scenarios specifically mentioned in this Ofwat letter we are very conversant with why charging which:-

- discourages self-lay by only offering asset payments based on 'lay-only' rates; and,
- prices checking (SLP submitted) designs at the same rate as companies charge for doing designs themselves; and,
- do not recompense SLPs for the all required site specific works when developers can procure, through requisitioning extensive 'site-specific feeder mains' at no added cost.

are all barriers to self-lay competition.

Based on what we were told when the Ofwat letter was issued our expectation was that the companies who methods of charging incorporated these practices would be prompted by the Ofwat letter to identify that they need to make changes. This however has not been the case as, with the exception of Yorkshire who (appear to have been in the fortunate position prior to 2018 of being able to fund income offsets from unutilised Infrastructure money) have made public their charging 'balance' assessment, we have not seen any response to the April 2019 letter from Ofwat, and certainly not any connection charges changes.

Instead, where we have taken the initiative in challenging companies, they have said that there is no method to change charges until next year but they will factor the issues into their 2020/21 charge review considerations. We regard this as being unreasonably constraining and urge Ofwat, at the next opportunity, to make it clear to companies how they can adjust their charges mid-year.

#### 5. Our Review Of Charging Against Ofwat Rule Criteria

We now have the benefit of water provision related data published by companies in their Annual Performance Reports to come to a view on:-

- a) How well aligned Infrastructure Charge income is to actual expenditure on network enhancements; and,
- b) Whether, based on the grants and contributions received totals, companies appear to be able to demonstrate that the balance of costs paid by customers prior to April 2018 is broadly aligned to what was paid in 2018/19.

We accept that our 'grants and contributions' assessment is somewhat crude and that there are now regulatory controls which require Infrastructure income and expenditure to balance over 5 years. Nevertheless our own assessment highlights that 5 companies, namely Portsmouth, United Utilities, Affinity, Anglian and South East took over 10% more from Developer Services customers in 2018/19 than they had previously. Also that 7 companies, Thames, Portsmouth, Southern, South West, Northumbrian, Wessex and Yorkshire spent less than 50% of the received water Infrastructure Charge monies.

Whilst acknowledging that the publically available figures do not give a complete picture, and that Ofwat have indicated that they did not adequately define what tests had to be satisfied when

companies set their charges to retain a 'balance with what was previously paid by customers' we maintain that the increases take from Developer Services customers by some company are at a level that merits further investigation by Ofwat. We also consider it is paramount that Ofwat quickly introduces a means which prevents companies, in the coming years and where there networks do not need more capacity installing, promoting extensive network enhancement works simply to use already collected income!

## 6. Elements In Payable Connection Charges

There are 2 key underlying issues regarding connection charging. The first is whether company charges are reasonable (for the efficient provision of necessary activities) and secondly whether they create a basis for fair competition. Whilst our focus, as an association supporting SLPs, is on the later (leaving developers to take the lead on reasonableness discussions) there are some charges which sufficiently stand out so as to merit being flagged by ourselves.

Before discussing charges themselves a model needs to be established which classifies the various discrete charging elements that arise on self-lay mains and service provision so that discussion on them can be aligned to the basis of each charge.

The charging elements (regardless of whether new water connection related works are provided through self-lay or by companies themselves) can be classified into:-

- a) Contribution to offsite network enhancements (paid through Infrastructure Charges); and,
- b) Various administrative and technical assessment charges covering (predominately office based) activities water companies do themselves; and,
- c) Work (typically providing the source of water connection) which is classified as non-contestable and whilst paid for by customers is always done by companies (or their contractors); and,
- d) Site specific mains and service laying work which is classified as contestable and can be done by SLPs; and,
- e) Work which is contestable but which a SLP asks the company to do on their behalf. This may include design plus on-site mains connections and sampling.

With regards these we comment that:

### 6.1 Plethora of Administrative/Technical Charges

Whilst we encourage unbundling of charges the new charging arrangements have produced, in many companies, a plethora of discrete charges which, when combined, make up a significant overhead burden which was not generally being directly charged to customers prior to 2018. Hence we ask Ofwat to establish that all these work activities now being charged arise when mains and services are provided through self-lay and that the level of charge is cost reflective. This is because customers have no choice but to pay whatever each company sets as their administrative/ technical charges.

To us this issue is most pronounced in the charges companies apply for handling service connection applications (which, for self-lay, we maintain actually forms part of the mains application processing) and administration associated with the making of each connection. Company charges for service connection administration and processing vary markedly with Affinity being the highest (with them charging £74.37 per plot on self-lay for a 100 unit

development). This is significantly more than the equivalent £16.28 (on the same sized development) for self-lay connections in Bristol Water (which they say have been set using an uplift on an Ofwat determination finding). We therefore ask Ofwat to review all companies whose various administrative, and technical assessment, charges are markedly higher than others.

Also for Ofwat to review where companies look to charge significant amounts for activities which should be simple to do. Example of this being the £464 charged by South West and £460 by Wessex for issuing a self-lay agreement (which we maintain should be no more onerous than setting up a word processor to produce requisitioning terms).

## 6.2 Lack of Differentiation Between Self-Lay and In-House Provision Charges

A separate, but aligned, charging matter is the lack of differentiation between the amounts companies charge for administrative, and technical assessment, tasks between when connection provision is done by themselves and by a Self-Lay Provider. Whilst, for some tasks, there may be no difference the savings to companies when SLPs do significant task elements themselves needs, for competition to function, to be fully reflected in company charges. This situation is exasperated when charging elements gets bundled together.

We therefore ask Ofwat to review all companies who do not show sufficient differentiation between the charges applied to in-house provision and self-lay provided works.

## 6.3 Design Charges

Design should be an openly contestable activity but various factors, including both lack of differential charging and the low charges of some companies, mean that in many companies it is not worthwhile for SLPs to do designs themselves. Hence this is a key area for Ofwat to now investigate.

The situation is confused by some companies bundling design into application processing and others, such as Anglian, only charging a deposit which although has differential rates they then fully refund (so annul the difference) when the work proceeds.

## 6.4 Assigning Charges to Site Specific Works (when they should be applied to Network Enhancements)

A key element in the current charging arrangements is the separation of 'site specific' and 'network enhancement' works with the site works charged against what needs to be constructed and any necessary off-site works recovered through Infrastructure Charge payments.

To make it easy to determine the joining point between these components a pragmatic definition for the Chargeable Point of Connection has been established. This basically requires sight of a mains plan for the adjoining area so that the nearest main which is either bigger or of equivalent size can be determined. Once this has been done a SLP can proceed with advancing the site specific works whilst the water company determines what, if anything,

needs to be done to ensure that the Point of Connection is capable of supplying the new development.

Whilst recognising that the network upstream of a Point of Connection may need to be modelled the cost of this work should surely become part of company's Infrastructure Charge build-up and not be charged as if it were a site specific cost element. Ofwat are therefore asked to determine whether the practices of companies, such as Affinity (who will not consider a design application until they have been paid to produce a Pre-Planning Report) are charging in accordance with the Ofwat Rules.

Furthermore we ask Ofwat to consider the process constraint caused by the many companies who are not providing ready access for SLPs to view their mains records. This hinders self-lay provision in ways which do not arise when companies produce designs themselves.

#### 6.5 Potential for Company Contractors To Distort The Connections Market

Although companies may maintain that their construction charges are based on the rates agreed with their contractors it will, where self-lay is more established, not have gone unnoticed by these contractors that they are losing work to SLPs. A way company contractors can counter this situation is to enhance their charges for works which are classified as non-contestable (such as the primary source of water connection to the existing network) and correspondently reduce their charges for the contestable work elements. This can mean that the company pays no more when their contractors is tasked with doing all the work but that the contractor is much better placed to recover significant overheads when they just do the mains connection.

Hence Ofwat is urged not to accept any company who says that their rates just reflect their contractors charges and to probe to establish that the charges for each element of non-contestable works is actually being set on a cost reflective basis.

#### 6.6 Tackling Unrealistic Rates

Our members have difficulty in seeing how some companies are able to offer construction rates which are well below the labour and material costs a SLP incurs when doing the same activity. In this regard we ask Ofwat to review:-

- a) The Anglian rates for on-site mainlaying; and,
- b) The service connection charges both South West and Wessex apply when they do the work themselves.

We also highlight that the cross company construction rates for doing the same activity show some very wide ranging variations. An illustration of this being the rate for laying a 125mm diameter PE main, which range from £33/m in Anglian to £220/m in Thames. *(Note – we recognise that some cross company variance may arise from the bundling of associated fittings by some companies but that these should not account for a 7 times variance).*

From a competition perspective it is those companies whose charges are below the cost base of SLPs which cause the greatest concern. Hence Ofwat is urged to investigate all companies whose construction rates, both for mainlaying and comparable service laying, are in the lower

quartile of those of all companies. This is to establish that they are not being cross subsidised by other (possibly administrative overheads or non-contestable elements) charges.

## 7. Company Structure, Organisation and Responsiveness

We consider that asking for organograms of developer services teams is too narrow a request. This is because Developer Services is primarily an office/front end of processes section and that works delivery for customers is highly reliant on others sections from across each company.

In this regard whilst Thames, United Utilities and Severn Trent have established a best practice self-lay focused teams these companies can still struggle with always getting company provided works delivered by other departments to match with works programmes agreed between Developer Services and SLPs. Elsewhere the situation is made worse by very tenuous organisational links between Developer Services and company delivery departments. In Southern Water this includes the scheme specific Project Manager (who looks over the whole project and supplies the self-lay agreement) not working for Developer Services with their nominated Key Account Manager only becoming involved in the case of escalations or driving improvements. They also have field based New Works Technician who do all inspections but, from (painful) SLP experience, are not managed by Developer Services and who are not always consistent in their requirements (which is made worse by Southern Water not having yet issued a technical specification manual for SLPs to access).

We also maintain that companies integrate their wholesale and retail functions involved in supplying new developments in ways which harms connections competition by making in-house provision easier to progress. We therefore find it surprising that Ofwat has not probed companies about ensuring that organisationally there is a level playing field between the way in-house and self-lay applications are progressed.

## 8. Further Design Considerations

In addition to the lack of charging differential discussed above SLP willingness to take responsibility for design is impacted reference by:-

- a) Design specification manuals not being made universally available by companies (despite the Ofwat Adoption Code making this a requirement from January 2018); and,
- b) The requirements on SLPs submitting a design being much more onerous than what a company does/provides when they issue designs to a SLP; and,
- c) Experience indicating that it can be difficult to satisfy company design approvers (who can have 'individual preferences'. *(Note – there being little come back against this when reference design manuals are not available).*

Whilst there are many factors, including having the necessary skill set and the workload to justify resourcing, which influence the take-up of SLP design it is company behaviour in not offering design manuals and showing a willingness to reliably, and promptly, process applications/move towards self-certification which are key constraining factors. These, with pricing, are preventing design becoming universally viable as a competitive provision offering. We consider these needing to be urgently tackled by Ofwat as we regard it imperative that SLPs should have an unrestrained choice as to who does self-lay designs.

## 9. Bureaucracy Constraints

Exasperated by the plethora of charges discussed above SLPs find the, somewhat bureaucratic and antiquated, way many companies choose to work hinders the advancement of self-lay. This is because each process stage has a charge and until companies have reconciled that they have received payment they will not start the work (or their response time counter).

Whilst recognising that the move to connection charging against Ofwat Rules was the first really significant change that Developer Services have experienced in decades there is a desperate need for companies to operate to 21<sup>st</sup> century business best practices and not constrain connection competition by continuing with working methods from previous eras. Hence Ofwat is urged to recognise this issue and to take action with companies who slow processing down by always demanding pre-payment or only advancing competitive connection work on a step-by-step basis.

A further process constraining factor is that companies when doing the work themselves invariably do not separate 'wholesale' and 'retail' activities (and in many situations the same person works in both these areas). This means that companies do not encounter the many (bureaucratic) interfaces SLPs need to work through on self-lay provision. So Ofwat action is needed to remove such workflow constraining barriers.

## 10. Work in the Highway

In some companies on-site self-lay connection work is now reasonably well established. However off-site work, which invariably involves work in the highway is not attractive to SLPs. Partly this is because the work content is relatively small but the main factor is that SLPs have to pay for their own street opening licence whereas companies, as statutory undertakers, do not pay highway authorities in the same way. Given that SLP works are adopted by companies it is difficult to see why SLPs should not, and in the same way as company contractors, be able to use the street opening arrangements of companies. If Ofwat is interested in prompting greater connection competition then this constraint on work in the highway needs to be removed.

## 11. Raising Challenges

The role of Ofwat in handling charging disputes changed in April 2018 and since then the number of referrals has, in all probability, dropped. There are a number of reasons for this, including:-

- it is known that Ofwat cannot resolve charging matters in 'real time' (i.e. before a SLP commits to a job) so invariably, with self-lay, walking away from a project is safer than committing to work whilst relying, to make it viable, on a settlement; and,
- where charging issues arise on specific projects, which are caused by the way companies have chosen to structure their local charging arrangements, it is (possibly to avoid any criticism of their Rules) known that Ofwat is more minded to prompt companies into reviewing their arrangements than tackling specific abuses; and,
- there is evidence of referred new charging issues not being deemed sufficiently substantive for Ofwat to initiate an investigation; and,
- Ofwat insists that charging matters are always first referred to companies. Some companies are now more responsive than others but it takes much energy and time and although this can result in some movement (though invariably the same issue gets repeated on the next project!) it can result in a SLP deciding to walk away from doing the work.



So whilst Ofwat may wish to take comfort from any fall-off of case referrals we do not think that the number of case requests is a good indicator of customer dissatisfaction. We therefore earnestly ask that Ofwat takes action to follow-up the multiple charging issues discussed above as we see this vital to establishing a fully functioning competitive water connections market across England. Also, allowing for processing time as we are so near the 2020/21 charge publication date, we consider it essential that it is made clear to companies that they can make changes during a charging year. Particularly when the changes are necessary to remove market competition barriers.

## 12. Concluding Comments and Giving SLP Confidence

Discussed above are many charging related matters which constrain the universal advancement of self-lay competition. Ofwat is therefore asked to work through these and establish a 'level playing field' for all who wish to operate in the competitive water connections market.

Whilst the wide array of charging matters discussed need to be tackled the advancement of self-lay competition is also being held back by the sceptical way some companies continue to treat SLPs (especially when the SLPs concerned know much more about this type of work than companies themselves!). Making this situation worse is the:-

- lack of published specifications and guidance; and,
- somewhat bureaucratic and archaic methods of working; and,
- many separate process stages, each requiring a form, whose purpose is not well signalled (or linked to process maps).

Hence much needs to be done to prompt all companies to be sympathetic, in their behaviour, towards connections competition and to introduce simple clear and transparent processes and guidance. Sadly this does not look to be being offered in the latest water Adoption Arrangement proposals. We therefore can only hope that Ofwat recognises that direct involvement by themselves is urgently needed to ensure a free and open market for water connection competition and one that provides genuine choice to developers (and any others requiring new water supplies).

With regards water connection charging the highest priority matters, and ones which we view as paramount that Ofwat quickly tackles, are:-

1. Company charges for doing work themselves which are markedly below the costs a SLP incurs when doing the same work. (*Above we have cited examples covering on-site mains construction work, the provision of service connections and scheme designs*); and,
2. Addressing the much more bureaucratic processes, with many 'wholesale'/'retail' interfaces and more 'charging points' with self-lay than arise when companies do the work themselves; and,
3. Ensuring that all charges are cost reflective, especially those for administrative and technical work which have to be done by companies themselves.

Because it needs addressing, and will also illustrate what else needs to change, we urge Ofwat to take action and make design, both in terms of pricing and access to necessary 'material information', a viable competitive offering. Ideally this being linked into giving SLPs access to company mains records and thereby facilitating self-determination (by SLPs) of where the 'Point of Connections' is located. The purpose of this being to enable SLPs to improve their delivery by being able to progress designs at a much earlier stage.

Where developers experience self-lay connection provision it invariably leads to them wanting to continue with this method of working on subsequent sites. We also know of developers who elect to go self-lay even when it is more costly than company provision! There are however, as discussed above, many factors which still constrain competitive water connections provision. So whilst we are encouraged that Ofwat has now asked companies to provide information on how they are working to develop effective competitive water connections markets we continue to view both company behaviour towards self-lay and their pricing policies as materially hindering this market. The view of our members is that there is much evidence of abusive company behaviour which is hindering, and damaging, the development of water connections competition. We therefore trust that Ofwat will now respond to our prompts once they have (hopefully quickly) critically reviewed the company returns.

The response has been submitted by:-

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Tel – ██████████, Email – ██

██████ should be contacted over any queries which arise from this response. Also if substantiation of the various, company specific, charging matters is required.