Water UK response to Ofwat consultation on Charging Arrangements for new connections services for English companies

Introduction

This response has been prepared by Water UK and has been approved by its members. It addresses only questions 7 and 8 of the consultation.

The consultation proposes that Water UK establish a working group to prepare a common methodology for the calculation of charges. This work would consist of two elements-first, a harmonisation of terminology and secondly, a harmonisation of methodology. The consultation suggests that the first substantive phase of this work could be completed by summer 2022 in relation to on-site charges and be ready for implementation in relation to off-site charges in 2023.

Our comments relate to the following issues which the proposals raise:

1 Possible application of competition law
2 Scale of undertaking and timescale
3 Achieving a successful outcome

Potential application of competition law

Water UK was keen to see the sector adopt a common approach towards the original new connections rules and in 2017 commissioned Reckon to draw up guidelines which would help members adopt a consistent approach to the broad charging rules that Ofwat had adopted, preferably using a single template for quotations. Our aspiration at the time was for there to be a single approach to questions such as how to maintain a broad balance of charges between developers and other customers before and after implementation of the new rules.

Our ability to go beyond the general guidance which we ultimately issued was however significantly constrained by the cautious advice we received from Aidan Robertson QC. In summary, his advice was that the harmonisation of approach envisaged by the Water UK work and the related information exchange would be likely to be seen as a breach of the Chapter 1 prohibition and require an analysis of the exemption criteria under section 9 of the Competition Act 1998. We were unwilling at the time to devote the significant resources to the process of applying those criteria to the particular project.

We have reconsidered this advice in the light of the current proposals. We are aware that a number of our members are likely to take a positive view of the ability of the sector to work together in the way that Ofwat proposes.

However, while it is correct that our members do not compete amongst each other for the supply of these new connections services, there are a number of ways in which this work could affect competition.

First, the work that is envisaged by Ofwat's proposals would lead to the disclosure of information which could influence the way in which water companies contract with third parties.

At present, members contract individually with their delivery contractors and we are aware that different approaches can be adopted to the pricing of these contracts. Some companies' contracts, for example, may bundle together charges for individual jobs on the basis that the costs of pricing

every job individually may outweigh the potential savings. Other contracts could be based on individual pricing of every job based on a precise schedule of materials.

It therefore follows that even in the absence of information about pricing, the exercise that Ofwat is proposing will reveal information which has the potential to change the way in which water companies contract with their external contractors. We note that competition law does not focus only on competition between the parties to the collaboration that is under examination.

While the work on terminology may pose less of a risk, it cannot be ruled out that the discussions on a common terminology and the agreement to adopt one could have the negative consequences referred to above.

We would also note that the work to be carried out could have implications on the markets for SLP and NAV services as they would be dealing with a different, but more harmonised, charging regime. Such companies may well benefit from such a regime but it may also be the case that some will find themselves disadvantaged, if for example the new incumbent charging regime reduces their competitive advantage. The test under competition law is whether competition is prevented, restricted or distorted-it is not just about obviously negative effects.

The risks that we have outlined could however be avoided if the scope of work to be carried out by the working group were to be specified by Ofwat under its regulatory powers. This would protect the work being done by the group from the application of competition law. Rules could be adopted to ensure that the collaboration within the group did not extend beyond the permitted area.

We understand that both in the cases of the DCUSA and the CiC Code of Practice, this was the approach adopted by the relevant regulator.

Ofwat has itself referred to this possibility in the consultation and from the perspective of Water UK, a regulatory instruction to companies to compile the necessary documents would enable us to play the role that is envisaged.

Scale of undertaking and timescale

Having worked on the adoption code documentation, we give our perspective on some of the practical implications of this proposal, if the current delivery model is retained.

Undertaking this work is likely to require the following resources.

1. Subject matter expert working two/three days a week. We are not aware of any consultants who would have the necessary expertise and this might therefore require the employment of an external consultancy.
2. Permanent representatives from the water companies, able to devote time to this work. Given the number of differing approaches currently being adopted, the scale of the task of harmonising should not be underestimated-say, at least a day a week per person. Note that companies are likely to want to have representation both from their developer services and regulatory teams.
3. Input from customers. This has proved particularly difficult to obtain during the codes work as developers and SLPs are often not able to release people to provide the depth of input that is required. We are unsure of the extent to which the HBF would be willing to devote resources to such a project and on the SLP side, we are hesitant about institutionalising the position of Fair Water Connections given their role as a lobby group rather than a recognised trade body.

4 Management from Water UK to liaise with members, arrange finances, take responsibility for delivery.
5 Website creation and maintenance-again this would need to be contracted for.

We suggest that a minimum of a year will be required to deliver the first phase of work. Meeting Ofwat's aspiration to introduce substantive changes in April 2022 will depend on when work starts. This in turn is likely to be dependent on the timetable for the introduction of a regulatory requirement to carry out this work.

If, by way of illustration, the necessary requirement is introduced in December 2020, allowing work to begin in January 2021, this would imply finishing the work in December 2021. Companies are likely to be unable to use the outcome of that work in the preparation of their charges from April 2022 as these are typically finalised six months before 1 April.

Achieving a successful outcome

The earlier sections of this response set out our views on some practical issues relating to the delivery of this work. In this section, we consider the potential barriers to achieving a successful outcome to the project.

Our views on this topic are informed by the work carried on to implement the adoption code.

We suggest that the biggest barrier to achieving a successful outcome is the difficulty of securing customer agreement to the output from the working group. We understand the need for Ofwat to retain the final say in accepting the work of the working group but this does unfortunately allow customers a second opportunity to comment on documentation on which they will already have been consulted.

In the water adoption code work, for example, based on the outcome of a workshop with the most significant SLP customers, water companies believed that the changes they had made to their initial proposals had made the package of documentation acceptable.

However, when that documentation was then presented to customers by Ofwat in a further consultation, new objections emerged. This ultimately led to the need for two significant revisions of the work initially carried out by the water companies.

The question therefore is how a definitive outcome can be reached if the process is in the hands of water companies, as is currently proposed.

We propose therefore that the work be led by Ofwat from the start. Water companies would be happy to contribute to this work by way of a working group. Having such leadership would avoid the "second bite of the cherry" problem referred to earlier and has the potential significantly to reduce the time taken to deliver the work. This would also resolve the competition law problem referred to above

We would be happy to work with Ofwat to set up a group of this nature.

Final comments

Based on our experience when the new connections rules were first introduced, we are cautious about the prospects of the work delivering the outcome that Ofwat wishes.

The terminology that individual companies use in their contracts reflects a commercial decision by each company as to the basis on which it wishes to contract. This in turn will reflect its assessment of how best to deliver the services to commercial customers. If for example, a company adopts an approach under which individual jobs are measured, it would seem inevitable that adopting a common terminology will require the contract to be renegotiated.

Adopting, again by way of example, the model of "short length" and "long length" pipes would be likely to run counter to the contract's approach to measuring jobs individually. It is not clear how such changes could be introduced into existing contracts without giving suppliers an opportunity to renegotiate the terms more widely.

The problem becomes more acute if the work Ofwat is proposing produces a harmonised methodology. This would inevitably require contract renegotiation as no company will wish to offer terms to commercial customers which are not mirrored in the terms they have negotiated with contractors. To do otherwise would introduce an unacceptable degree of uncertainty and risk into the model. The problem of contract renegotiation would arise in a more acute form.

Harmonisation of methodology would reduce innovation and differentiation between companies. Given the nature of comparative competition between water companies, it is difficult to see how this would be to customers' benefit.

Responses to questions 7 and 8

7 For the reasons noted above, we do not support the adoption of common charging methodologies. Any decision to adopt common terminology would need to be phased in over an appropriate period.

8 Given the competition concerns raised by this work and the difficulty of securing customers' endorsement of changes, we consider it essential that any work carried out in this field be the subject of a regulatory requirement. Our preferred alternative would be for the work to be led by Ofwat.

Water UK

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