



# Fair Water Connections

An association seeking a fair deal in water supply provision

## Response to Consultation on new connections charging rules for Welsh companies

1<sup>st</sup> March 2021

This response is from Fair Water Connections which represents SLPs from across the self-lay community. Many of our members currently do self-lay work in Wales and are keen for the connection charging arrangements in this area to change as our members recognise that retaining the current charging arrangements is far from preferable and something they would like to see changed. Our members preference is for the offered Option 2 as they have much experience of anti-competitive connection charging practices which need the structured requirements of this option to get companies to recognise that their charging behaviours need to change.

### ***Q1 Do you agree with our proposal to redefine what costs are recovered by infrastructure and requisition charges?***

We fully support establishing 2 clearly defined work categories associated with connecting new developments which do not overlap. These are the necessary site specific works and any required network enhancements. Both need to be defined in ways which do not create ambiguities and we commend Ofwat to use, as the divide point, the Chargeable Point of Connection which is defined as the nearest main/sewer to the development that is of the same equivalent size of larger. To us the Chargeable Point of Connection needs to be added into the set of definitions in the proposed Rules.

The split between the work categories does however need to cover the situation where enhancements (either upsizing or additional connections) are required on the site specific work content with the cost of such 'extras' being funded from Infrastructure Charges.

We cannot see that the wording in the offered Option 3 gives the necessary definition clarity between 'site specific' and 'network enhancement' works sufficient to ensure that there is no possibility of customers being charged twice for the same work. This is a further reason for our members rejecting this option.

### ***Q2 Do you agree with our proposal that infrastructure charges should be calculated to recover costs incurred over a rolling period of years?***

We fully recognise the need for Infrastructure Charges to form the funding of network enhancements. Our members however strongly feel that their ability to compete in providing connection services is adversely harmed by Infrastructure Charge rates being reset each financial year. This invariably triggers a charging change mid project which causes our SLP members to have to go back to their developer customers to renegotiate terms because this particular rate has, outside of their control, been changed. This is a historical aspect of connection charging that our members now wish to see changed so that they can position themselves to deliver each project

without having to re-open charging discussions with their customer.

*(Note – our members would like this to also apply to work in English companies).*

Whilst we are relaxed about the ‘balancing’ frequency we earnestly ask Ofwat to establish an Infrastructure Charge framework where the rate can be fixed for a complete project and thereby avoid financial year end changes (which can occur relatively soon after terms are agreed if a project is started late in the financial year).

We also ask Ofwat to recognise that future Infrastructure Charges could, if the Ofwat proposal is accepted, be associated with any Income Offset balancing. So our view is that these 2 elements should be (effectively) considered as a combined charge and the same (whole project life) arrangements put in place for both.

We also cannot see why Income Offsets should change on an annual basis. Our view is that Ofwat should agree Income Offset allowances on a per connection basis with each company at the date the new arrangements commence with this adjustment amount then continuing in perpetuity. Ideally this would leave the Income Offset component in the background with Infrastructure Charges defined as incorporating the Income Offset component.

A further related matter is that, in our view, the new arrangements in Wales should make it clear how any water efficiency discount applied to Infrastructure Charges is to be funded. To us there is much ambiguity about this in England and it needs to be made obvious to customers whether any discount is funded by companies themselves (as they benefit from not having to increase treatment capacity which is not directly funded by developers) or through subsidy from those connection where customers continuing to pay the full (undiscounted) Infrastructure Charge amounts.

***Q3 Do you prefer option 2 or option 3 (or another approach) as the basis for setting the relevant time period over which costs are calculated for the purpose of setting infrastructure charges?***

It is the lack of transparency and openness in the setting of Infrastructure Charges which is an issue to ourselves as our members have no means of scrutinising the way this charge is derived or have any knowledge of the regulatory checks Ofwat does to establish that associated expenditure is genuinely being spent on network enhancements.

In our view considering a 10 year balancing horizon would only make this matter worse and instead we commend Ofwat to move to determine both Infrastructure Charge amounts and Income Offsets as part of each company’s regulatory pricing review. This should then bring some scrutiny to the aspect of connection charges which is not subject to any competitive comparison testing. It would also address the apparent disconnect between what developer services specific regulatory settlement a company has and the monies they raise through connection charging.

For such an arrangement to now operate it would mean that the first period (i.e. up to the next regulatory review) would be shorter than 5 years but charge setting could then be taken forward on a rolling 5 year basis.

***Q4 Do you agree with our proposal to simplify the calculation of income offset and apply it to the infrastructure charge, instead of the requisition charge (thereby removing the need for asset payments)?***

We agree that connection competition arrangements are made clearer when Income Offsets are removed from the site specific work components. This then means that the providers offer is based on cost and expected delivery rather than the cost proposition being distorted by the way the Income Offset discount gets applied. We therefore support this Ofwat proposal.

But, as we have covered in our response to Question 2 we are looking to Ofwat to:-

- fix the Income Offset discount at the start of the new arrangements and for this then to not be changed on an annual basis; and,
- introduce a composite Infrastructure Charge and Income Offset charge and thereby avoid customers having to themselves having to combine 2 separate charging elements.

We however recognise that the transfer of Income Offset from the provision of site specific mains and allocating it to all service connections means that money that was only being applied to around 75% of all connections gets distributed, as a lesser (per plot) discount, across all connections. To mitigate the impact of this on connections provided to on-site developments some form of transition arrangements surely needs to be set-up and defined in the Rules.

***Q5 Do you think option 2 or option 3 is the better approach to setting upfront charges for site-specific developer services? Or would you prefer another approach?***

We urge Ofwat to make it a requirement on Welsh companies to publish their charges such that developer customers can readily pre-determine themselves the costs to connect a new development and have discussions about costs with competitive providers before becoming 'locked' into detailed charging discussions with the incumbent company. The offered wording for Option 3 removes many of the requirements necessary for this to happen. This again reinforces our preference for Option 2.

In making the request to facilitate customer being able to pre-determine charges we recognise that, particularly with Hafren Dyfrdwy, company's previous experience may not facilitate them being able to confidently issue rates for all work that could be necessary but sense that companies should be in a position to cover most routine work types in a pricing schedule.

In setting out our members strong preference for Option 2, with companies publicising their detailed charges, we recognise that developer customers in England have been slow to move to operate on a self-serve basis. But as confidence is gained in the new charging arrangements (especially when it is remembered that individual developers may only take forward a single site each year) we sense the ability to pre-price will advance competition. This leads us to conclude that Option 3 is unacceptable to the self-lay community as it does not appear to open up competition or make charging provisions for non-incumbent providers sufficiently 'simple and transparent'.

In England, where Option 2 is now established, a number of companies are offering their developer customers spreadsheets covering all of their published rates. These are now being routinely used by customers to price up jobs and form the basis of offered terms. To our members it would be a loss if such arrangements were unable to work in Wales.

**Q6 Do you think option 2 or option 3 is the better approach to setting charges for requisitions and new connections? Or would you prefer another approach?**

Whilst recognising that providing Welsh companies with the freedom to set bundled composite rates simplifies charging we can evidence that this approach can be detrimental to competition. This has led to all, but one, of those English companies who initially introduced a per plot mainlaying charge to revert to charging for the work specifically required to supply each site.

*(Note - we are currently consulting with our members about making an Ofwat referral regarding South West Water's charges as whilst, after lobbying from our members, they have made some changes in their 2021/2 connection charges their 'bundled' approach still does not work well on various site layouts). [This section in italics is to be removed if this response is published by Ofwat].*

The anti-competitive factors that we have engaged with a number of English companies over, and led to them recognising the need to move to charge on a length of pipe installed basis, include:-

- Wide cost differences between work in contaminated ground and where barrier pipe is not required. The one English company who still charges for mains on a per plot basis now has rates of £1209/property in contaminated ground and £412/property elsewhere. (There 2020/1 composite rate, which shows bundling distortion, being £646/property); and,
- Sites (and particularly first phases) with extensive length from the site boundary to the first property, or where distributor mains are required, or when initially only one side of a road is to be developed; and,
- Where upsizing enhancements are required (and there is no differential to credit a competitive provider with the additional work they are required to install); and,
- Lack of separation, through bundling, of contestable and non-contestable work components.

In giving this feedback we recognise that, in the short term, generous per plot credits (where easy to serve sites are bundled with sites with higher servicing costs) can be attractive to competitive providers. But such an approach invariably leads to market tension when customers have to be told that on some higher cost to service sites a SLP cannot compete against the in-built cross subsidy in the incumbents pricing.

Furthermore, looking ahead, once the incumbent has lost the attractive/easy to serve sites to competitors they are then going to either have to fund the subsidy on other sites themselves or increase their rates. Over time this is surely going to lead to sites being charged using rates which closely align with the actual cost to service. So why would a company not want to move to this situation straight away?

In making these comments we recognise that companies do not always experience the actual cost to serve amounts as their contractors will have tendered on the basis of a mix of work across geography and provision difficulty. We however maintain, as has happened in England, companies can much better balance reasonable installation costs against their charging structure in an Option 2 charging approach.

***Q7 Are there any charging rules that have been included under options 2 or 3 that are not required due to the general requirements of the charging principles?***

We do not wish to see any of the specific Charging Rule requirements removed so that the only way of tackling perceived competitive charging abuses is through a general principle. This is based on the experience of what we have been able to ourselves progress with English companies, without referrals to Ofwat, by just pointing out what specific Charging Rule requirements prescribe. Should this change, and reliance have to be made against the general requirements then subjective judgements will be required and disputes referred to Ofwat to get meanings clarified. This would surely effectively end up with additional requirements either being added to the Rules or the precedents from cases having also to be followed. So it would avoid time delays, and be much preferred by our members for the initially issued Rules to fully specify all of the required charging behaviour.

***Q8 Are there any additional charging rules that should be included under options 2 or 3?***

Whilst the offered wording for Option 2 looks reasonably complete a weakness (which equally applies in the English Connection Charging Rules) is that whereas the section on requisitioning and enhancements is reasonably prescriptive these requirements are not fully replicated in the adoption requirements section. This has led to us having to get companies to recognise that it would be anti-competitive not to apply the requisitioning requirements to self-lay.

Hence our view is that Paragraph 29 needs replicating in the 'Charges and Asset Payments in respect of an Agreement under Section 51A or 104 of the Water Industry Act 1991' section. This is because although such upsizing could equally arise on a self-lay delivered scheme it is not explicit that the SLP should be paid for the additional installation costs they incur.

Our suggested wording is:-

*Where an Undertaker is adopting a Water Main or Public Sewer through an Agreement and, in so doing, decides to increase the capacity of pipes or other infrastructure beyond that which is necessary to service the development covered by the Agreement the additional costs on the installer shall be paid by the Undertaker. The basis for this payment being the reasonable increased installation costs based on the proportion to the cost of installing the particular capacity required to service the development covered by the Agreement.*

Should Option 3 to taken forward our view is that much of the clause removal (which strips out Paragraphs 7, 11, 12, 13, 14, 16, 22, 28 and 43) is to the detriment of defining charging in ways which gets a reasonable balance between companies and their developer customers. Whilst many companies consultation rounds are not as well managed, or as open, as our members would like the requirement (in Paragraph 7) to consult provides formalised opportunities for discussions which do not currently happen in Wales. We therefore ask that Ofwat neither loses this facility or the various requirements aimed at getting companies to define the work incorporated within each charge in the Welsh company arrangements.

We also maintain, as discussed against Question 1, that the Chargeable Point of Connection should be included within the set of definitions.

***Q9 What are your views on the three proposed options? Which of the options do you prefer?  
Would you prefer another approach?***

As covered above our members welcome the proposals to move Welsh companies away from the current connection charging arrangements. We support, with the changes referred to above, the Option 2 proposal but maintain that the shortcomings with Option 3 are such that it would place competitive providers at a significant disadvantage when working in the area of Welsh companies. We therefore urge Ofwat to discount consideration of this option.

***Q10 Are there any other issues we should consider as part of our assessment of the impacts of introducing the proposed charging rules?***

Although they have taken a while to get established we view the worked examples Ofwat has prescribed for English companies as of great assistance in customers better understanding company charging structures. They also facilitate discussion around charging issues being able to happen before the time critical progression of terms on each scheme. We therefore ask that the requirement to provide costed examples gets extended to cover work in Welsh companies.

We are also encouraged by the Ofwat moves towards greater standardisation of charging terminology and the way activities get bundled together. Hence we are keen for this, now ongoing, work to also be applied in Wales.

The response has been submitted on behalf of Fair Water Connection members by:-

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Martyn should be contacted over any queries which arise from this response.