Fair Water Connections

An association seeking a fair deal in water supply provision

Response to Statutory Consultation on updating Ofwat's Charging Rules

August 2021

This response is from Fair Water Connections which represents SLPs from across the self-lay community. Our members work across all water company areas. Whilst encouraged by many of the Charging Rule Changes that Ofwat is now proposing (in the documents accompanying their statutory consultation on their proposed changes) there are some detailed aspects where we maintain further changes are necessary to remove ongoing competition barriers and make the proposals more workable from a customer perspective. We therefore ask that the additional changes requested below are made.

Given that the SIA Partners connection charging analysis report underpins the latest Ofwat proposals we take this opportunity to provide a commentary on aspects of this report which relate to self-lay charging matters. Many of these tie into the Charging Rule changes that we are now requesting.

Section 1 – Commentary on Aspects of the SIA Partners Root Cause Analysis Report Covering Connection Charges for Developer Services in England

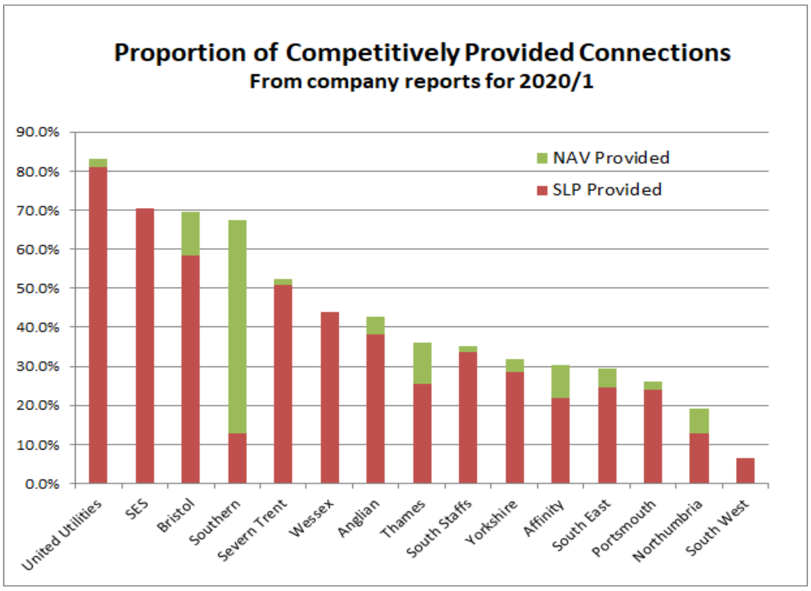
In many aspects the SIA Partners report further highlights the connection charging discrepancies that we know exist across water companies operating in England. Many of these are frequently encountered by our members who then struggle when competing either against high non-contestable charges (where company contractor's rates are well beyond what our members consider as 'reasonable') and/or against low company provision rates. In places, where we believe that company contractors have, for themselves, advantageously structured the rates (which companies merely then pass onto their customers), both of these factors can come together to seriously disadvantage connection competition.

The price differential difficulties our members face can be masked by already achieved market penetration levels, and hence we maintain that aspects of the SIA Partners analysis on current activity levels is not necessarily reflective of the rate differential difficulties currently encountered. But they do (as shown in SIA's Table 1, below) provide a validated reference to the wide cross country variances.

2021/22	Scenario 1 (Single connection)		Scenario 2 (10-house development)		Scenario 3 (50-house development)		Scenario 4 (50-house development with SLP involvement)	
	Costs	Charges	Costs	Charges	Costs	Charges	Costs	Charges
Median	£2,197	£2,093	£17,997	£17,997	£64,937	£65,038	£6,641	£6,554
Max	£3,684	£3,650	£35,118	£29,420	£109,217	£147,590	£15,404	£14,680
Min	£926	£926	£10,479	£10,479	£30,837	£39,216	£483	£483
Mean	£2,233	£2,181	£18,203	£17,847	£69,969	£72,630	£7,279	£7,148

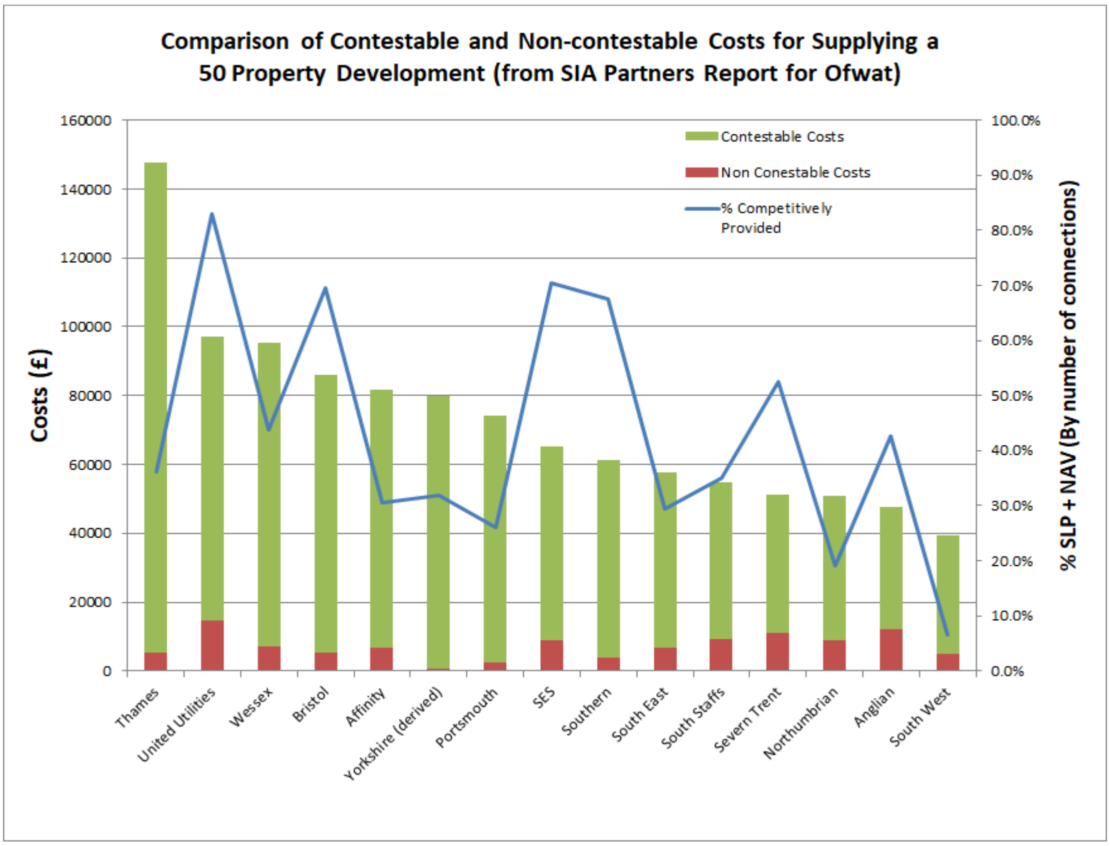
Given the nature of our members work it is the site development findings (so Scenarios 3 and 4 in the SIA report) that are of most interest to our members. Hence these are the ones we consider further.

Somewhat disappointingly SIA do not appear to have identified that, in a competitive provision perspective, their Scenarios 3 and 4 need considering alongside each other. This is because Scenario 4 provides the non-contestable cost elements which run alongside the contestable components detailed in Scenario 3.



Another apparent omission is that SIA do not look to have identified that developers can choose either NAV provision or self-lay (and, for various factors, take-up of these differs across companies). So (as shown in our chart) we are of the view that total competition provision, so both SLP and NAV, needs to be combined in the analysis. To do this we have drawn on the data provided by companies in Table 4Q of their Performance Reports for 2020/1.

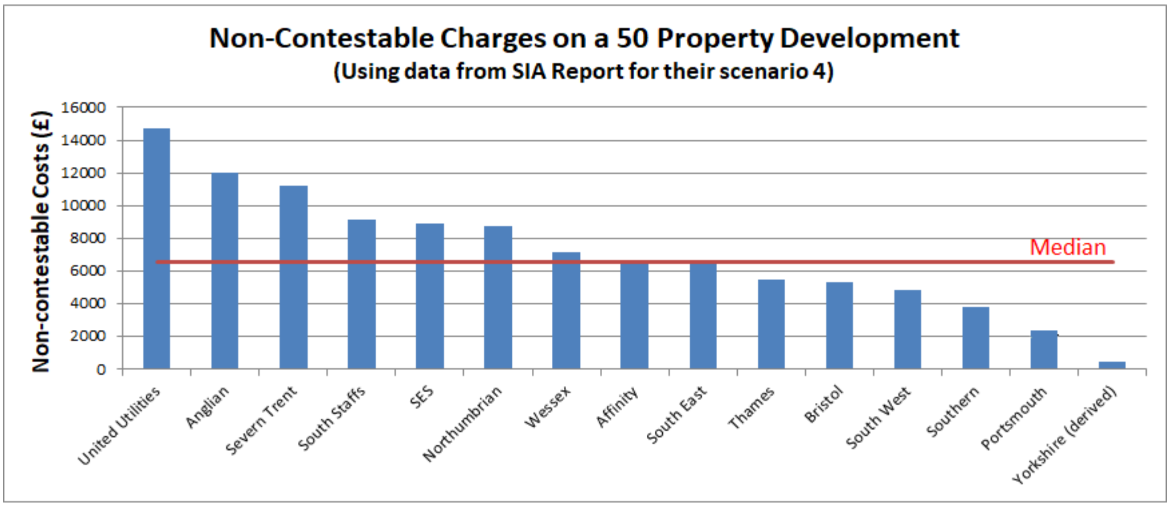
Bringing these together in the following chart we show the total (requisition) costs from scenario 3 but identify (in red) the 'non-contestable' costs from scenario 4. Against this we plot the proportion of competitively provided (from both SLPs and NAVs) connections in 2020/1.



It has to be recognised that many factors, and much history, influence competitive take-up. Competitive penetration also gets distorted when a company's area contains discrete regions where one patch contains the bulk of the competitive provision. This arises with Thames, where self-lay in the Thames Valley is much higher than in the London conurbation, and in the regional differences between the component parts of South West, South Staffs and Northumbrian Water.

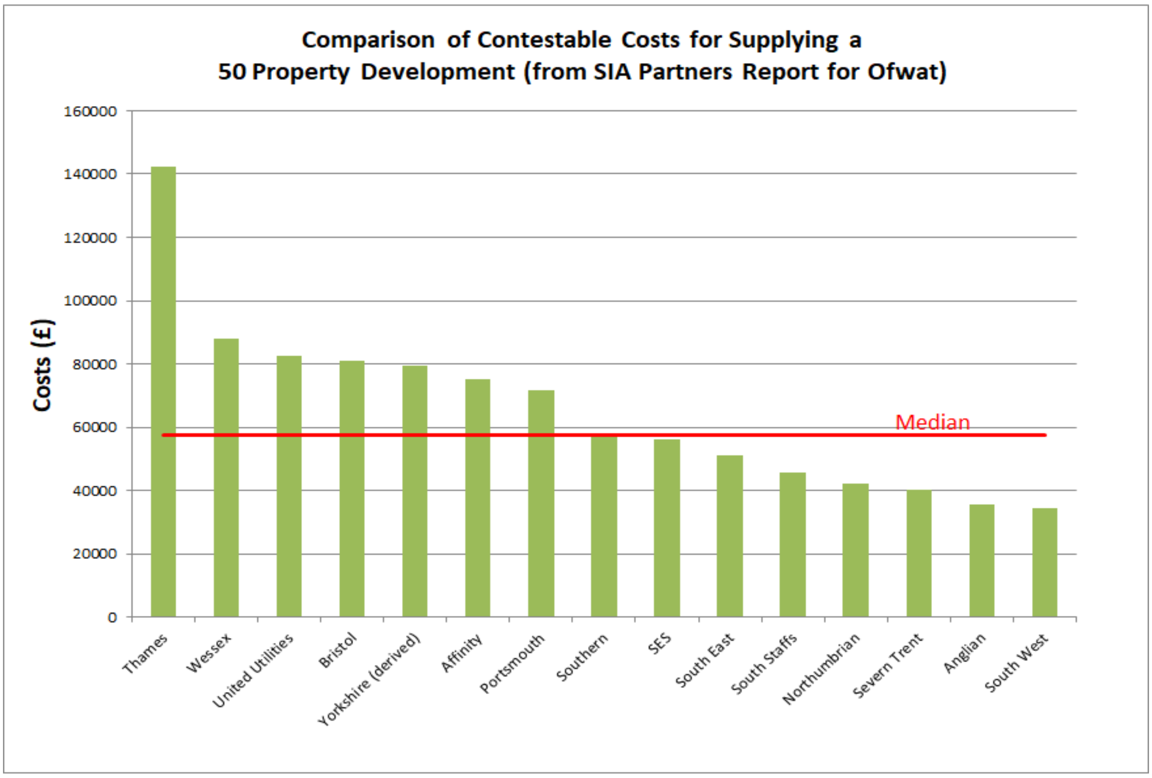
Hence, as looks to have been done by SIA, viewing current activity levels without recognising how long ago this was established, is, in our opinion, far too simplistic. There can also be company specific year on year 'quirks' as particular large developments get advanced. Nevertheless, especially where self-lay is less established, there looks to us to be a general correlation between where competition is less prevalent and where developers are charged the least when the companies do the work themselves!

When we drill, as shown in the following chart, into company's non-contestable charges it is all too apparent to us that those companies where self-lay competition has been established the longest are the ones (on the left of our chart) whose non-contestable charges are, by far, the highest.



Our view is strongly that this situation is because the contractors these companies use have recognised that weighting their rates for 'non-contestable' work, and balancing this against lower 'contestable' work elements, has no consequence to them should they be awarded a full scheme but proportionally increases what they get paid when they only get asked to do the (minimal) Source of Water connection.

Further consideration (in the following chart) of those companies who charge least for contestable works, especially when this is linked (as shown above) to high non-contestable charges, shows (in those sitting below the median) where SLPs face material financial market entry barriers.



As we do not feel that the competitive market implications on self-lay provision has been sufficiently researched by SIA we ask that Ofwat considers the points concerning competitive market considerations we are making and ensures, as discussed below, that necessary changes are made to their Connection Charging Rule changes.

Section 2 – Matters Flagged as Failing to Facilitate Competition Fairness

Point 1 - Ensuring that Company Charging Reflects Reasonable Costs

Although recognising that it is proposed to add a new general charging principle worded to say that "charges covered by these rules should reflect costs of the relevant service" we do not consider that this is sufficient to energise companies towards addressing some of the charging anomalies we evidence above.

The proposed addition also looks to fail to materially move the arrangements towards the "cost reflectivity" that Ofwat appears to be striving, albeit now in the longer term. Without enhancing the Rule wording our view is strongly that companies will continue to pass on their contractors rates (saying that these are "their costs") without any necessary "balancing" between "contestable" and "non-contestable" components. This has to be to the detriment of connection competition and is therefore something we urge Ofwat to address in their latest Connection Charging Rule changes.

In pressing for Ofwat to now do much more in terms of highlighting the importance of "cost reflectivity" we note the points made by Ofwat (in their consultation document) about harmonizing the various comments made by respondents to their earlier consultation. But we cannot see how moving towards "cost reflectivity" is going to happen if Ofwat's concluding words from their Section 2.2.3 consultation response are not, in any meaningful form, transferred into the Connection Charging Rules.

So we struggle to understand (using Ofwat's words) how "having this new general principle also highlights the importance of striking the right balance between cost-reflectivity and the other charging principles, such as stability and predictability" when none of these aspirations get transferred into the Rules that companies are required to follow.

This to us, as an organisation that has hitherto achieved some worthwhile realignment in local charging arrangements by highlighting to company's what the Ofwat Rules require, will be a blocker to us picking up the charging level conversations that we feel need to be had before 2022/3 charges get set. We therefore stress, based on our experiences, that companies are unlikely to make their charges more "cost reflective" in the eyes of their customers if they can continue to claim that they are merely passing on their contractors rates.

Hence we propose, for Ofwat's consideration, and in line with what is now clearly a longer term aspiration, that an additional requirement is added to the Information Requirements Annex to the Connection Charges. This requiring companies to annually "explain how their charges are fairly balanced between 'contestable' and 'non-contestable' components".

If this does not happen we will be looking to Ofwat for some guidance as to what constitutes a competition compliance charging abuse regarding how companies position their 'non-contestable' and 'contestable' charges in relation to total provision costs. This is because making such referrals would then be the only action our members could take when pricing barriers, as we suspect will increasingly occur (should changes in the way contractors are allowed to price does not happen). Thus preventing SLPs competing with incumbent providers on connection work.

Point 2 – Point of Connection Terminology

In the set of Common Terms, that it is expected companies to use in their local charging arrangements, the concept of an "Alternative Point of Connection" has been introduced.

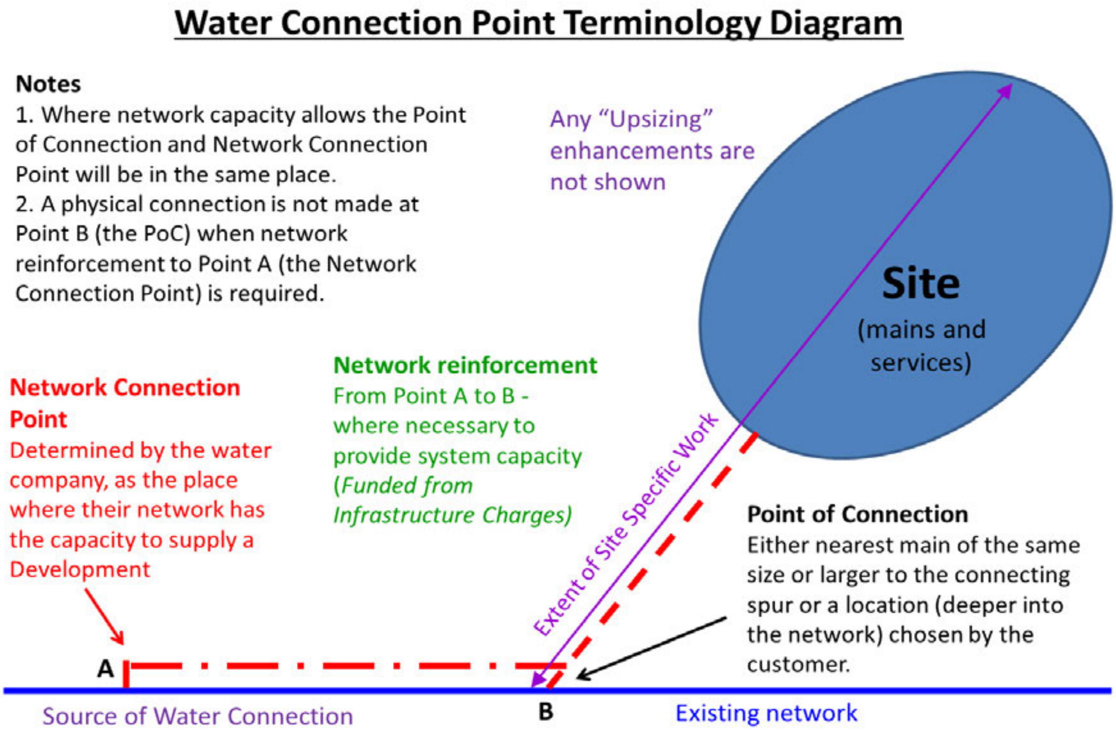
Given that the Point of Connection, with a new positioning variation (which we recognise as an improvement), is to be defined as either:-

i) a practical location indicated by a Developer Customer where the existing water main or sewer is the same size or larger than the new connecting main or sewer or, where they have not indicated a location; or,

ii) the nearest practical location where the existing water main or sewer is the same size or larger than the new connecting main or sewer.

And an "alternative" is, by definition "one or more things available as another possibility" the "Alternative Point of Connection" in the context of water connection charging looks to be meaningless. It also confuses matters from a customer's perspective regarding where the delineator between customers directly funded 'site specific' works and Infrastructure Charge funded "network reinforcements" is located.

Our proposal is therefore that thoughts of an "Alternative Point of Connection" get removed but that a "Network Connection Point", as explained in the following diagram gets added. This then introduces customer understandable terminology which is linked to the need, where it arises, for the Source of Water Connection to be made 'deeper' into a company's network.



For the reasons discussed above we ask that Ofwat removes the proposal to define an "Alternative Connection Point" but introduces (what we think was probably behind what companies/Water UK requested) a "Network Connection Point". This being defined as "the point, determined by the water company, where their network has the capacity to supply (or drain) a development".

Furthermore we are of the view that companies hinder competition understanding by not covering upsizing enhancements in their charging practices and worked examples. These are material issues on self-lay work which do not arise on company/requisition provision (where the higher costs of installing 'enhancements' do not get passed onto the customer). So whilst welcoming the proposed inclusion of 'upsizing' in the definitions we are of the view that competition would be much aided by:-

a) The addition of "Enhancement Payments" in the definitions. This being defined as" payments made to the installer when the water company requires the installed works to be upsized"; and,
b) An upsizing situation being added into a worked example. Thus providing an illustration showing how a company operates their "Enhancement Payment" provision which can then be reviewed (and tested) well in advance of site specific terms being requested.

Another Point of Connection charging matters is that because of the poor connection type definitions (see Section 5 below) customers are exposed to companies applying "Source of Water" connection costs at the "Network Connection Point" when customers are only responsible for paying for what it would cost to do the work at the "Point of Connection" (regardless of whether work is actually done here). To us what is legitimately chargeable regarding connection costs is not clear in the Ofwat Rules and we therefore ask that this is rectified.

Point 3 – Incorporating Infrastructure Charges into Connection Charging Rules

We welcome the transfer of Infrastructure Charging requirements into the Connection Charging Rules and expect this to drive improvements in the level of information companies provide about these charges.

With many companies now providing Infrastructure Charge discounts based on water efficiency, or sustainable drainage incentives, our view is that these need to be explicitly linked into the proposed Infrastructure Charges and Income Offsetting (English Undertakers) section in the Connection Rules.

Our proposal for doing this would be to introduce into Paragraph 57 of the Connection Charging Rules a new subsection (between the current [a] and [b]) which states:-
"the Charging Arrangements clearly set out how any discounts that are applied to Infrastructure Charges (such as water efficiency and sustainable drainage incentives) function and what is necessary for a discount to be offered".

This should then ensure that these discounts form part of a company's local charging arrangements and that the discounts themselves are covered by the paragraphs within the Publication and Transparency section of the Rules.

We particularly ask for this addition because our members have had experience of discount arrangements being changed during a charging year. They have also encountered difficulties when, post initial application, they have sought to secure the discount on their schemes.

Point 4 – Incorporating Infrastructure Charges into Connection Charging Rules

In addition to the above points we raise below various aspects of the proposed terminology which are of concern and which we request get changed.

These are:-

1. That we view it as somewhat confusing that Ofwat is proposing 2 separate sets of terms. These are the "Interpretation" set under Section 5 of the Connection Charging Rules and the "Common Terms" associated with the Worked Examples. To aid customer understanding and usability we ask that these get combined into a general use set (even if Ofwat is minded just to use a subset in their Rules document).

2. Whilst a definition against "Branch Connection" is included in the Common Terms the wording describes all generic types of connections rather than what would be recognised as a "Branch Connection". To rectify this we propose:-
    a. that a "Routine/In-Line Mains Connection" be added. This meaning a connection made to a newly laid main that does not supply customers and where the supplying main can be controlled by a valve, or can be squeezed off, without affecting existing customers; and,
    b. that the "Branch Connection" gets replaced by a "Source of Water Connection" which means a connection of new mains to the existing mains network, usually through a branch connection, into a 'parent' main which supplies customers.

   These changes would then align connection descriptions with the terminology already in use in the Water Adoption Arrangements.

3. We are confused be the way that Ofwat is now proposing to define "Site Specific" and cannot see why this has been changed to wording that is not readily understandable to customers. Also we cannot see why, because they are already generally understood, that 'On 'and 'Off' Site definitions are now needed. Our view is that underpinning the charging arrangements is the concept of "Site Specific" which extends to the Point of Connection (which may be either 'On' or 'Off' site for all types of connections; i.e. mains, services, sewers and drains). So our view is that the "Site Specific" definition does not need changing and, to do so, would confuse customers.

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.