

Protecting consumers, promoting value and safeguarding the future

**Guidance on financial arrangements for
self-lay and requisitioning agreements
– version 2.0**

www.ofwat.gov.uk



About this consultation

The purpose of this document is to explain the principles that water and sewerage companies should follow when calculating the charges and payments that are made when new infrastructure is installed. It applies either when companies requisition assets or developers install their own assets (self-lay), which the company then adopts as long as all the relevant conditions are met.

We expect each company to observe closely the principles that underpin this guidance and base their own policies on it.

We welcome stakeholders' views on any aspect of the guidance. In particular, we would welcome comments on the following.

- 1) Do you have any comments or suggestions regarding our new worked example?**
- 2) Do you believe our principles are still fit for purpose? If not why not?**
- 3) We have tightened up the wording of principle 11 regarding the level of security/deposit that can be requested. Do you agree with our proposal to make companies that request deposits greater than 100% of the discounted aggregate deficit (DAD) to provide justification up front?**

Contents

Responding to this consultation	3
1. Introduction and purpose	4
2. Background	7
3. Installing new water mains and service pipes to supply water for domestic purposes	10
4. Principles for calculating the components of charges and payments for requisitioning and self-lay of water pipes	15
5. Non-contestable costs	25
6. Security	26
7. Supplies for non-domestic purposes	28
8. Installing new sewers	29

9.	Infrastructure charges and network reinforcement costs for water main and sewer installation	32
10.	Interest rates for requisitioning – borrowing and deposits	35
11.	Charging for new infrastructure when a new licensee enters the market	36
Appendix 1	Template of non-contestable costs	37
Appendix 2	Contestable and non-contestable work	39
Appendix 3	Regulatory impact assessment	40

Responding to this consultation

Please send responses to this consultation to Andrew Walker by **31 October 2008**.

You can e-mail your responses to andrew.walker@ofwat.gsi.gov.uk

or post them to:

Andrew Walker
Consumer Protection
Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA.

Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FOIA), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

If you would like the information that you provide to be treated as confidential, please be aware that, under the FOIA, there is a statutory ‘Code of Practice’ with which public authorities must comply and which deals, amongst other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

1. Introduction

The Water Act 2003 (WA03) changed the ways in which water and sewerage companies¹ reach agreement with developers about installing new water mains, service pipes and sewers.

When we last issued this guidance in 2004, we considered it important to review it in light of how the self-lay and requisitioning market has worked in practice.

We are aware that the financial arrangements can be complex and difficult to explain. This revised guidance provides more explanation of:

- relevant deficit;
- asset payments; and
- discounted aggregate sum.

We have also included worked examples at the end of chapter 4. These were previously included as an appendix to the guidance. We have simplified these examples and stated the assumptions behind the calculations more explicitly. In addition, by placing the worked examples next to the explanatory text we have made the guidance easier to use and understand. More work is now contestable when compared with the previous guidance, which is reflected in this version.

We have made some stylistic changes to this version of the guidance. We have, for example, listed the principles that underpin this guidance in a table at the start of the document.

This guidance should be read alongside our 'Guidance on competition in providing new water mains and services pipes', which we are reviewing at the moment.

¹ Water or sewerage companies are companies who hold Instruments of Appointment as water or sewerage undertakers under the Water Industry Act 1991 (WIA91).

1.1 Principles that underpin our financial guidance

Principle 1	Water companies' estimates should be based on robust and transparent information about the anticipated costs of the work. It is advisable for developers to provide timely and reliable information about the work that is needed so that water companies can provide estimates that are timely and accurate.
Principle 2	Water companies should assess the components of the charges and payments in the same way whether they are estimating or calculating the asset payment or estimating or calculating the requisition charges.
Principle 3	Estimates of revenue should be calculated on the basis of the average metered charge per property. Water companies should also take account of the future revenue that will be recovered from supplies for non-domestic purposes, where this can be assessed.
Principle 4	The relevant deficit should be calculated on the basis of the revenue that is payable, not the revenue that has been received from a newly-connected property.
Principle 5	Water companies should allocate 100% of the revenue from newly-connected premises as the income allowance.
Principle 6	The discount rate that water companies use should be the same as the rate of interest for borrowing.
Principle 7	Water companies should forecast the long-term effects of inflation and adjustment factor (K) on anticipated revenue when calculating the statutory commuted sum charge or the asset payment.
Principle 8	Water companies should take account of developers' submissions to estimate when income starts to become payable for a property.
Principle 9	Water companies should complete a cost breakdown template for each job, including all the costs of non-contestable elements of self-lay work and the estimates for statutory commuted sums and asset payments. We expect the cost breakdown template to at least match our model as set out in appendix 1.
Principle 10	Water companies should not insist that security be provided in one particular form but should offer a choice of payment methods to the developer.
Principle 11	When works are requisitioned and the water companies require an undertaking or security, we can in general see no reason why a water company should ask for security that is more than 100% of the estimated statutory commuted sum. If a water company requests a security or undertaking greater than the estimated statutory commuted sum it should provide full justification at the time of making the request.
Principle 11a	The undertaking or security should be returned within six months of the relevant deficit becoming zero or when the finalised statutory commuted sum is paid, unless the water company can provide justifiable reasons for holding the security longer.
Principle 12	When a water company requires security for self-laid works, this should cover the reasonable potential cost of remedying minor defects in the SLO's work and the reasonable costs of the non-contestable work, where these have not already been recovered.
Principle 12a	This security should be held until the SLO has paid the charges for the work that has been carried out and the defects liability period or maintenance period is over.
Principle 13	Water companies should consider developers' requests to self-lay non-domestic supplies. Water companies do not need to make an asset payment for self-laid

	mains for wholly non-domestic purposes.
Principle 14	Sewerage companies' estimates of relevant deficit and statutory commuted sum charges for sewer requisitions should be based on robust information and calculated consistently.
Principle 15	Principles 4-8 relating to the calculation of charges for requisitioning water mains should be applied to the calculation of sewer requisitions charges.
Principle 16	When calculating the charges for self-laid sewers, sewerage companies should not pay developers an asset payment.
Principle 17	When sewers are requisitioned and the sewerage company requires security, the sewerage company should ask for no more than 100% of the estimated statutory commuted sum unless there are justifiable reasons for doing so. If a water company requests a security or undertaking greater than the estimated statutory commuted sum, it should provide full justification at the time of making the request.
Principle 18	When considering disputes about the level of charges for network reinforcement we will take account of the infrastructure charges that have been or will be raised for that development.

2. Background

2.1 Provisions relating to installing new infrastructure

When a new water main or sewer is needed, the owner or occupier of the premises can ask the water or sewerage company to install the pipework. When a new water supply or sewer is required for domestic purposes, this is known as requisitioning.

There are two mechanisms for paying for requisitions under the Water Industry Act 1991 (WIA91). Requisitioners can either:

- make yearly payments to water and sewerage companies for up to 12 years (the relevant deficit option); or
- pay a statutory commuted sum, the discounted aggregate deficit (explained in more detail in section 3.1).

Alternatively, the owner or occupier of the premises may choose their own contractor to carry out the work, which the local water company then adopts. This is known as 'self-lay'.

Under section 51A(1) of WIA91, water companies can enter into agreements with developers constructing or proposing to construct new water mains and service pipes. If the pipes are constructed in accordance with the terms of the agreement, the water company must connect them to the existing network and take over responsibility for, or "adopt", them. When a main is built to supply water for domestic purposes and the water company adopts it, sections 51C(1) and (5) WIA91 require water companies to make a payment in recognition of the revenue that will be recovered from newly-connected properties. The payment will be made to the person who enters into a self-lay agreement with the water company. This can be either a developer or their contractor. This payment is explained further in section 3.2.

There is no specific provision covering the installation of pipes by self-lay organisations (SLOs) to supply water for non-domestic purposes. But under WIA91, a water company can agree to take responsibility for these pipes if a third party lays them. Principles 3 and 13 explain the policies relating to installing pipes to supply water for non-domestic purposes.

This guidance also explains payments for requisitioned sewers and why sewerage companies should not make payments to developers for self-laid sewers. It does not cover any charges for self-laid sewers that are referred to in the WRc publication, 'Sewers for Adoption' (6th edition was published in March 2006). This is a guidance

document published by agreement between sewerage companies and the construction industry.

We expect each company to publish transparent information about the policies it operates. This information should be accessible on the company's website. This information should include meaningful and clear worked examples of the relevant deficit, discounted aggregate sum and asset payment. We also expect companies to publish schedules of charges for non-contestable work.

2.2 Dispute handling powers

Under WIA91 we have powers to determine disputes. We will consider each case on its merits and this guidance provides a framework we will use to consider disputes. We expect each company to follow both this guidance and our earlier guidance on 'Guidance on competition in providing new water mains and service pipes'. When deciding the outcome of disputes, we will take into account whether the company's policies meet the principles set out here.

We can determine disputes in the following areas.

- Financial conditions of water, sewer and lateral drain requisitions. This will include disputes about the level of security (deposit) and charges for the work.
- Completion date and route of requisitioned water mains or sewers and lateral drains.
- Water companies' refusals to enter into agreements to adopt self-laid water mains and the terms and conditions of such agreements, including charges.
- Financial conditions of agreements to self-lay water mains, including the level of security and charges for the work.

Our process for considering these disputes is set out in our [guidance](#). This document is not a substitute for WIA91 or any other relevant legislation. It should be read in conjunction with the relevant legislation. Anyone in doubt about how the legislation may affect them should seek independent legal advice.

2.3 Consultation process

We are seeking stakeholders' views on this amended guidance. We intend to publish revised guidance by the end of 2008. This guidance should be read in conjunction with our 'Guidance on the competition in providing new water mains and service pipes'. This document is subject to a separate review and, again, we intend to

publish this by the end of 2008. We have also discussed the principles set out in this guidance with our industry advisory group, the Ofwat Self-Lay Group (SLG). This group includes developers, self-lay contractors and representatives from water and sewerage companies.

3. Installing new water mains and service pipes to supply water for domestic purposes

Water companies will need to either calculate actual costs or estimate notional costs to produce the charges or payments for installing new water mains and service pipes. Estimated costs should be reasonable and robust. This chapter outlines how charges should be calculated or estimated in accordance with WIA91.

We can only look at disputes that the provisions of WIA91 cover. We cannot intervene if a developer enters into an agreement with a water company outside of the provisions of WIA91.

3.1 Charges for installation when the water company installs new pipes

Each company should calculate requisitioning charges based on the following.

- (a) Under section 43(2) of WIA91, water companies are entitled to recover the costs reasonably incurred in providing the new water main. This includes, among other things, the reasonable costs of design, labour, plant, materials, reinstatement, quality testing, mains flushing, inspection, supervision, traffic management and administration costs. We do not consider that this amount should include any allowance for profit. There is no provision under WIA91 for water companies to make a profit on their charges for this work.
- (b) Section 43(4)(a) of WIA91 also provides that water requisitioning charges can include any costs reasonably incurred in providing other water mains and any tanks, service reservoirs and pumping stations that are needed because of the provision of the new main. These costs are usually referred to as network reinforcement.
- (c) Under section 43(4)(b) of WIA91, the water company can also charge the requisitioner a reasonable proportion of costs reasonably incurred in providing additional capacity in some existing mains, where this is used because of the new main. The water company should be able to show the requirement for a developer to pay for additional capacity through rigorous network modelling.
- (d) Requisitioning charges do not include the costs of laying and connecting communication pipes (usually the part of the service pipe between the main

and the boundary of the highway in which the main lies). The costs of this work should be recovered separately under section 45 of WIA91.

- (e) Similarly, the requisitioning charges should not include the costs of any pipe diversions the water company has been asked to make under section 185 of WIA91. Companies can recover these costs separately.

3.1.1 Paying for requisitions

WIA91 requires the water company to offer the developer the following payment choices.

Relevant deficit charges

Under section 43(2) of WIA91, the relevant deficit is defined as the amount (if any) by which the annual borrowing costs of a hypothetical loan for the cost of providing the new main exceeds the revenue for that year from customers connected to that main. The relevant deficit is calculated and payable over a period of 12 years after the main has been provided so it is based on the actual costs of carrying out the work.

The water company is not required to make a payment to the requisitioner when the revenue from the newly-connected premises exceeds the costs of financing the new main. At this point, the relevant deficit becomes zero. Because of this, the allowance made for revenue will not equal the actual revenue received if this is higher than the annual borrowing costs of a loan. The capped level of revenue that is used to calculate requisitioning charges (and asset payments which are explained below) is referred to in this document as the income allowance.

Please see the worked example at the end of this chapter.

Payment by statutory commuted sum

Developers can also pay for mains using the discounted aggregate deficit (DAD) method, which is sometimes referred to as a single statutory commuted sum. Sections 43A(1) and (6) of WIA91 state that this is an amount equal to the sum of the estimated relevant deficits for each of the 12 years following the provision of the main, in each case discounted to a net present value. Net present value is a standard financial method for appraising long-term projects which measures the excess or shortfall of cash flows in present value, once financing charges are met.

Under section 42(2)(a)(ii) of WIA91, the finalised statutory commuted sum is payable when the work has been completed and the actual costs of the work are known. These costs should be used to calculate the finalised statutory commuted sum

charge. This amount may include an amount for network reinforcement (see chapter 9). To complete the calculation of the statutory commuted sum, the water company will have to estimate the costs of a hypothetical loan and the revenue that it will receive from newly-connected properties.

Before the work is carried out and the actual costs are known, the water company will need to estimate the statutory commuted sum, including the costs of carrying out the work in order to complete the cost breakdown template (see principle 9 and appendix 2). So, once the main has been provided and the actual costs of the work are known, the finalised statutory commuted sum charge may vary from the original estimated commuted sum charge. The more information a developer can supply to the water company up front about a site, the less likely the initial estimate will change significantly.

Once the finalised statutory commuted sum has been paid, water companies cannot recalculate the amount and ask for more money. Section 42(6) of the WIA91 states that when the finalised statutory commuted sum has been calculated, including any amount for network reinforcement, any dispute about the amount of the statutory commuted sum can be referred to us for determination.

Companies should refer to the relevant principles set out in chapter 4 to calculate the relevant deficit and statutory commuted sum.

3.1.2 Infrastructure charges

As well as the requisitioning charges, a developer will also have to pay an infrastructure charge for each new connection to a main. An infrastructure charge is a fixed charge that is usually payable each time a new connection for domestic purposes is made. Companies are able to make such charges under section 146(2) of WIA91. However, if water has been supplied to a site in the last five years we expect the company to provide the appropriate credits to reflect the previous water usage on site. Infrastructure charges cannot be paid in advance, only when the connection is made.

Infrastructure charges are explained further in chapter 9.

3.2 Charges when the new pipes are self-laid

When a person requiring a new main for domestic purposes enters into an agreement with a water company to arrange for the pipes to be laid themselves, there will be various charges and payments for the work.

We would usually expect the agreement to be between the developer and the SLO, or the developer and the water company. For this reason, we have used the term 'developer' in the following text, although it also applies to circumstances where other parties (such as contractors carrying out the work) enter into agreements with water companies.

The developer or SLO will normally pay the water company charges for any non-contestable or contestable work that the water company has completed. Under section 51C(3) of WIA91, the company may also include an amount to cover costs equivalent to those explained at paragraphs 3.1 (b) and (c) above.

Definitions of 'contestable' and 'non-contestable' are included in our [glossary of terms](#). Appendix 3 includes a list of contestable and non-contestable work. .

The developer also has to pay the contractor for installing the mains.

The water company will have to pay the developer an asset payment (referred to in WIA91 as the discounted offset amount). This payment is an allowance for the revenue that the water company will receive from the properties connected to the new main.

3.2.1 Calculating the asset payment

Under sections 51C(6) and (9) of WIA91, the asset payment is calculated as the sum of the estimated offsets for each of the 12 years following the adoption of the main, in each case discounted to a net present value. The offset is the lesser of the estimated revenue from the adopted main or the annual borrowing costs of a hypothetical loan for the costs of providing the main. This mechanism ensures that the revenue is capped in the same way as when requisitioning charges are calculated. (See section 3.1.1 for an explanation of this.)

The asset payment is payable when the water company adopts the main and section 51C of WIA91 states that it should be paid within a reasonable time period not exceeding 28 calendar days. The calculation is based on estimates of the annual borrowing cost and the revenue that will be received from newly-connected properties, as well as water companies' robust and challengeable estimates of how much the overall cost of the work would have been if they had carried out the work themselves as part of a requisition.

Before the work is carried out, the water company will need to estimate the asset payment in order to complete the cost template. Once the work has been carried out

and the asset payment is due, the final calculation may be adjusted to account for changes in estimates of revenue or the overall costs of the work. For this reason, the final asset payment may vary from the original estimated asset payment.

Once the asset payment has been made, the water company cannot make any further adjustments to the sum.

Water companies should follow the principles set out in chapter 4 when calculating the asset payment. As an example, the asset payment calculation should include:

- design;
- preparation of agreements;
- construction; and
- supervision or inspection.

Because such items are included in the commuted sum payment where a main has been requisitioned, we expect self-lay work to be treated in the same way.

Under section 51C(11) of WIA91, disputes about the level of the asset payment can be referred to us for determination. We can only formally consider these disputes after the work has been completed and the payment becomes payable. However, it is possible for SLOs or developers to contact us to discuss general principles, or if they feel the water company is not following the principles as set out in this guidance.

3.2.2 Infrastructure charge

The developer will have to pay an infrastructure charge for each new connection, unless credits are applicable. Infrastructure charges are explained in chapter 9.

4. Principles for calculating the components of charges and payments for requisitioning and self-lay of water pipes

4.1 Estimating the costs of the work

Principle 1: Water companies' estimates should be based on robust and transparent information about the anticipated costs of the work. It is advisable for developers to provide timely and reliable information about the work that is needed so that water companies can provide estimates that are timely and accurate.

Before the work is carried out, water companies will need to estimate the requisitioning charges and the asset payment. This will help them to complete the cost template and also to enable them to calculate any security required. Water companies should produce transparent and robust estimates of the cost of the work.

Estimates should include transparent itemised costings for all aspects of the work that water companies will carry out.

There may be costs that are incurred solely as a result of the work being self-laid (examples of these items are listed in the cost breakdown template in the supporting information to this guidance). Companies can recover their reasonable costs for this work. They should explain clearly at the beginning what costs may be incurred in this way.

If developments are large or will be completed in several phases, water companies may have difficulty producing accurate estimates. In these situations, developers should provide water companies with information in a timely manner. This gives the companies an overview of the demand from the site in the long term. Developers can then apply for new infrastructure in phases to mirror the completion of the development. This will help water companies to produce more accurate estimates.

4.2 Calculating the asset payment

Principle 2: Water companies should assess the components of the charges and payments in the same way whether they are estimating or calculating the asset payment or estimating or calculating the requisition charges.

Section 51C(8) of WIA91 states that when the revenue and annual borrowing costs are calculated for the purpose of producing the asset payment, they should be

calculated as if the work had been requisitioned. For consistency, estimates should also be made in the same way. This allows developers to compare the cost of self-lay with the cost of requisitioning.

The water company will need to produce a notional figure for the overall costs of the work when it calculates or estimates the asset payment. This should be the same as the company's estimate of the costs it would incur if the work was requisitioned. It should reflect accurately the construction costs for the chosen material.

There will be situations where the water company incurs costs solely because the work is being self-laid, as mentioned under principle 1 above. In such cases, these figures do not need to be included in the assessment of the notional total overall costs for the purpose of calculating the asset payment. (The company can recover the actual costs of this work separately as part of the charges that the developer pays to the water company for the work that the water company carries out.)

The asset payment should be calculated consistently at all times whether the work is part of a single pipe or a multiple pipe installation.

For consistency, each company should use the same criteria when it calculates or estimates the asset payment as it would when calculating or estimating requisitioning charges. As an example, companies may take account of periods when they will not receive any revenue when calculating the requisitioning charges (such as, if there are a number of holiday homes in the area). They should take account of these factors in the same way when calculating the asset payment. However, the water company assessment needs to be rigorous and is open to challenge if the developer provides sufficient counter-evidence.

4.3 Estimating the revenue

Principle 3: Estimates of revenue should be calculated on the basis of the average metered charge per property. Water companies should also take account of the future revenue that will be recovered from supplies for non-domestic purposes, where this can be assessed.

Water companies should make clear in their published literature the average charges they use and the factors they will consider when assessing the revenue that they will receive.

Companies should take into account regional variations in average water consumption. They should make clear the factors they consider when assessing the

revenue they will recover. Any assumptions that the company uses will need to be available to the developer in a clear and detailed format.

Sections 43(7)(a)(ii) and 43A(4)(a)(ii) of WIA91 state that when calculating the relevant deficit and statutory commuted sum, the revenue that should be taken into account includes charges that are reasonably attributable to providing a supply of water, whether or not that supply is for domestic purposes.

Supplies to commercial properties are not necessarily supplies for non-domestic purposes. Under section 43A(4) of WIA91, supplies of water for drinking, washing, cooking, central heating and sanitary purposes are supplies of water for domestic purposes even if, apart from some specific exceptions, the use of the property is commercial.

We recognise that it may be more complicated to assess consumption from supplies for non-domestic purposes. So, we expect each company to attempt to assess this consumption (perhaps using similar properties, premises or developments) to make this calculation.

As mentioned above, the revenue to be taken into account should be that which is 'expected to be payable' to the water company for the provision of a supply of water². When we consider disputes about the level of charges or payments for installing new infrastructure, we will have regard to whether the revenue is 'expected to be payable'. We will expect water companies to make sure that their estimates are robust. We accept that it is sometimes difficult to assess the likely revenue and we will take this into account as appropriate.

4.4 Calculating the revenue for the purposes of calculating the relevant deficit

Principle 4: The relevant deficit should be calculated on the basis of the revenue that is payable, not the revenue that has been received from a newly-connected property.

When the relevant deficit is calculated, water companies have to refer to the actual income they can recover from a property. They should calculate the relevant deficit using the amount of revenue that is payable. This is usually equal to what has been billed. Similarly, when the revenue is estimated, companies should estimate how much revenue will be payable and not how much income will be recovered.

² Section 43A(4) of WIA91.

Companies should make assess when income becomes payable (see principle 8).

4.5 Proportion of revenue that is allocated as income allowance

Principle 5: Water companies should allocate 100% of the revenue from newly-connected premises as the income allowance.

When calculating the charges and payments for installing new infrastructure, water companies should use 100% of the water charges that will be due from premises connected to that main for each of the next 12 years.

4.6 Applying a discount rate

Principle 6: The discount rate that water companies use should be the same as the rate of interest for borrowing.

Chapter 10 explains how the rate of interest for borrowing should be calculated. Setting the discount rate at the same level as the rate of interest for borrowing means that the calculations of the relevant deficit, statutory commuted sum and asset payment are made consistently.

The discount factor should be applied from the first year onwards, as set out in the worked example in appendix 2.

4.7 Applying a rate of inflation and adjustment factor (K)

Principle 7: Water companies should forecast the long-term effects of inflation and adjustment factor (K) on anticipated revenue when calculating the statutory commuted sum charge or the asset payment.

Each year, water companies are allowed to increase their average water charges by no more than RPI + K. RPI is the Retail Price Index (which is the measure of the rate of inflation) and K is the price limit that we set for each water company for each year of a five-year period.

Water companies should use the forecasts, which HM Treasury compiles in [‘Forecasts for the UK economy: a comparison of independent forecasts’](#), to provide a figure for long-term inflation.

Water companies should apply the inflation rates and K factors that are available for the years that these apply. They should then make a reasonable assessment of likely changes, taking into account previous K factor settlements and attempting to assess future investment plans and efficiency savings.

4.8 Estimating when the income becomes payable

Principle 8: Water companies should take account of developers' submissions to estimate when income starts to become payable for a property.

Under sections 43A(4) and 51C(8) of WIA91, water companies need to estimate the level of payable charges so that they can calculate the statutory commuted sum and asset payment. When calculating the statutory commuted sum, companies should start to estimate how much revenue will become payable when the main is provided. Asset payments should be calculated from when the main is adopted.

There are several different factors which affect this assessment, including:

- the build rate;
- the connection rate;
- the occupancy rate; and
- when the charges become payable.

These terms are defined in our [glossary](#). Each company should rely on its own information and that which the developer submits to assess when the charges become payable. Companies should explain the assumptions they make when assessing what charges become payable. They should also be flexible and review their assumptions if the developer asks them to or if the developer provides robust information suggesting that a company's assumptions are wrong.

Generally, we would consider that charges become payable when the water company can issue a bill, although the bill may not be physically issued until a later date. This is often at a date later than the actual occupancy of the property and may depend on the water company's meter reading cycle.

4.9 Worked examples

The worked examples below are for **illustration** purposes only. The figures used will not be the same as a real scheme which will have different costs and occupancy rates. Inflation rates may be different, as may K factor settlements. It is important to

highlight that the income for each property will vary from company to company. It may also vary within a company, especially where there is significant regional variation in income for each property, or where a company has different charging areas with different volumetric rates for water and sewerage services. Also the interest rates will vary. Changes to interest rates are published every six months on our [website](#).

Example 1: Variables and assumptions

Calculation of the relevant deficit, statutory commuted sum and asset payment	
1) Variables	
Total scheme cost	£35,000
Number of properties	150
Basic average income per property (before inflation and K taken into account)	£110
Borrowing interest rate	6.50%
Discount rate (must be same as rate of interest for borrowing)	6.50%
Long-term annual inflation	3.0%
Number of applicable years	12
Annuity factor	8.15873
Annual repayment (total scheme cost/annuity factor)	£4,289.89

Cumulative occupancy and projected yearly K factor

Note: The cumulative occupancy is the rate of occupation for each year. It may be a flat number a year or a formula (for example, the percentage of houses a year). When using percentages, figures can be sensitive to rounding up or down.

Application of assumptions

Year	Cumulative occupancy	Projected yearly K factor
1	10	0,0
2	75	0,0
3	150	0,0
4	150	0,0
5	150	0,0
6	150	0,0
7	150	0,0
8	150	0,0
9	150	0,0
10	150	0,0
11	150	0,0
12	150	0,0

Example 2: Calculating relevant deficit

The projected relevant deficit is the difference between the annual repayments of the loan and the revenue. The relevant deficit is capped at 0 when the annual revenue equals or exceeds the annual repayment of the loan.

In the example below, please note that in year two revenue is calculated by assuming an occupancy rate of 75 properties. This is then multiplied by a revenue figure of £110. Inflation of 3% will need to be added to the £110. This equals 75*£110 plus 3% inflation. This equals £8,497.50. The same methodology should be used when calculating year three onwards.

Calculation of the relevant deficit for the installation of water and sewerage infrastructure			
Year	Revenue	Annual repayments of loan	(Projected) relevant deficit
1	£1,100.00	£4,289.89	£3,189.89
2	£8,497.50	£4,289.89	£ –
3	£17,504.85	£4,289.89	£ –
4	£18,030.00	£4,289.89	£ –
5	£18,570.90	£4,289.89	£ –
6	£19,128.02	£4,289.89	£ –
7	£19,701.86	£4,289.89	£ –
8	£20,292.92	£4,289.89	£ –
9	£20,901.71	£4,289.89	£ –
10	£21,528.76	£4,289.89	£ –
11	£22,174.62	£4,289.89	£ –
12	£22,839.86	£4,289.89	£ –
Total	£210,270.99	£51,478.63	£3,189.89

Example 3: Calculating the statutory commuted sum for the installation of water and sewerage infrastructure

Year	(Projected) relevant deficit	Discount factor	Statutory commuted sum
1	£3,189.89	0.93897	£2,995.20
2	£ –	0.88166	£ –
3	£ –	0.82785	£ –
4	£ –	0.77732	£ –
5	£ –	0.72988	£ –
6	£ –	0.68533	£ –
7	£ –	0.64351	£ –
8	£ –	0.60423	£ –
9	£ –	0.56735	£ –
10	£ –	0.53273	£ –
11	£ –	0.50021	£ –
12	£ –	0.46968	£ –
Total	£3,189.89	8.15873	£ 2,995.20

Example 4: Asset payment made for self laid water mains

Year	Income allowance	Discount factor	Asset payment
1	£1,100.00	0.93897	£1,032.86
2	£4,289.89	0.88166	£3,782.22
3	£4,289.89	0.82785	£3,551.38
4	£4,289.89	0.77732	£3,334.63
5	£4,289.89	0.72988	£3,131.11
6	£4,289.89	0.68533	£2,940.01
7	£4,289.89	0.64351	£2,760.57
8	£4,289.89	0.60423	£2,592.08
9	£4,289.89	0.56735	£2,433.88
10	£4,289.89	0.53273	£2,285.33
11	£4,289.89	0.50021	£2,145.85
12	£4,289.89	0.46968	£2,014.89
Total	£48,288.74	8.15873	£32,004.80

Note: Asset payments should include the same items as those that would be included for the statutory commuted sum (i.e., the asset payment should take account of the total scheme cost as if the work was carried out by the water company under requisition and include things such as design, agreement and supervision costs).

Background calculations

Annuity factor calculation

The interest rate for the calculations below is 6.5%. The formula to calculate the annuity factor for each of the 12 years is as follows:

$$1/1+(\text{interest rate}) ^{(\text{number of the year})}$$

Year 1	0.93897
Year 2	0.88166
Year 3	0.82785
Year 4	0.77732
Year 5	0.72988
Year 6	0.68533
Year 7	0.64351
Year 8	0.60423
Year 9	0.56735
Year 10	0.53273
Year 11	0.50021
Year 12	0.46968

The annuity factor described above is the total of annual discounts.

The annual discount factor is calculated in the same way, i.e. $1/1+(\text{discount rate}) ^{(\text{number of the year})}$. Please note the discount factor is always the same as the interest rate. In this example it is 6.5%.

Full calculation using the figures used in the table above

Year	Cumulative occupancy	Basic revenue £	Inflation factor	Revenue with inflation added £	Yearly K Factor	Reckonable income (revenue with inflation plus or minus any K factor) £	Discount factor	Discounted value of reckonable revenue (reckonable revenue times discount factor) £	Annual repayments of the loan £	Capital payable per year £	Interest on the loan payable per year £	Year end principal outstanding £	(Projected) relevant deficit (annual repayments of the loan minus the reckonable income) £	Statutory Commuted sum (discounted value of relevant deficit) £	Income allowance (lesser of reckonable income or annual repayment of loan) £	Asset payment (Discounted value of income allowance)
1	10	1,100.00	1	1,100.00	0	1,100.00	0.93897	1,032.86	4,289.89	2,014.89	2,275.00	32,985.11	3,189.89	2,995.20	1,100.00-	1,032.86-
2	75	8,250	1.03	8,497.50	0	8,497.50	0.88166	7,491.90	4,289.89	2,145.85	2,144.03	30,839.26	-	-	4,289.89	3,782.22
3	150	16,500	1.06	17,504.85	0	17,504.85	0.82785	14,491.37	4,289.89	2,285.33	2,004.55	28,553.93	-	-	4,289.89	3,551.38
4	150	16,500	1.09	18,030.00	0	18,030.00	0.77732	14,015.13	4,289.89	2,433.88	1,856.01	26,120.05	-	-	4,289.89	3,334.63
5	150	16,500	1.13	18,570.90	0	18,570.90	0.72988	13,554.54	4,289.89	2,592.08	1,697.80	23,527.96	-	-	4,289.89	3,131.11
6	150	16,500	1.16	19,128.02	0	19,128.02	0.68533	13,109.09	4,289.89	2,760.57	1,529.32	20,767.40	-	-	4,289.89	2,940.01
7	150	16,500	1.19	19,701.86	0	19,701.86	0.64351	12,678.27	4,289.89	2,940.01	1,349.88	17,827.39	-	-	4,289.89	2,760.57
8	150	16,500	1.23	20,292.92	0	20,292.92	0.60423	12,261.61	4,289.89	3,131.11	1,158.78	14,696.28	-	-	4,289.89	2,592.08
9	150	16,500	1.27	20,901.71	0	20,901.71	0.56735	11,858.65	4,289.89	3,334.63	955.26	11,361.66	-	-	4,289.89	2,433.88
10	150	16,500	1.30	21,528.76	0	21,528.76	0.53273	11,468.93	4,289.89	3,551.38	738.51	7,810.28	-	-	4,289.89	2,285.33
11	150	16,500	1.34	22,174.62	0	22,174.62	0.50021	11,092.02	4,289.89	3,782.22	507.67	4,028.06	-	-	4,289.89	2,145.85
12	150	16,500	1.38	22,839.86	0	22,839.86	0.46968	10,727.49	4,289.89	4,028.06	61.82	0.00	-	-	4,289.89	2,014.89
Total		174,350.00		210,270.99		210,270.99	8.15873	133,781.87	51,478.63	35,000.00	16,478.63		3,189.89	2,995.20	48,288.74	32,004.80

5. Non-contestable costs

Principle 9: Water companies should complete a cost breakdown template for each job, including all the costs of non-contestable elements of self-lay work and the estimates for statutory commuted sums and asset payments. We expect the cost breakdown template to at least match our model as set out in appendix 1.

Developers will receive an asset payment. They will also be re-charged for the costs that the water and sewerage company incurs for non-contestable work.

The cost breakdown template in appendix 1 sets out the charges for non-contestable work that the water company may make. Appendix 2 sets out the list of non-contestable work and also the asset payment that the water company will pay the developer if a developer chooses to self-lay.

6. Security

Principle 10: Water companies should not insist that security be provided in one particular form but should offer a choice of payment methods to the developer.

Under section 42(6) of WIA91, water companies are entitled to ask for security before installing new mains in response to a requisition. We have powers to determine disputes about the security that a water company requires.

Water companies should offer a range of options for paying security, but it is for them to decide which security options they wish to offer.

There may be additional overheads associated with administering certain security methods. Water companies should explain and justify clearly at the start of the application process the extra costs that will be incurred.

Principle 11: When works are requisitioned and the water companies require an undertaking or security, we can in general see no reason why a water company should ask for security that is more than 100% of the estimated statutory commuted sum. If a water company requests a security or undertaking greater than the estimated statutory commuted sum it should provide full justification at the time of making the request.

Principle 11a: The undertaking or security should be returned within six months of the relevant deficit becoming zero or when the finalised statutory commuted sum is paid, unless the water company can provide justifiable reasons for holding the security longer.

Under WIA91, the statutory commuted sum will be payable when the works have been completed. The relevant deficit is payable over 12 years. We believe it is reasonable for water companies to require a security to cover the risk that they may not recover their requisition charges.

In most cases, the level of security will not need to be more than the estimated statutory commuted sum. In some circumstances, there may be an additional risk to water companies (for example with larger, multi-phased developments or developments which are largely commercial and therefore annual revenue is less predictable). In these circumstances, it may be reasonable for the company to require extra security or to hold on to the security after the relevant deficit has reached zero or the statutory commuted sum has been paid. In such cases, water

companies should state clearly why they believe a larger deposit is required, their policies and the increased costs that the requisitioner will incur. If any dispute about the level of security is referred to us, we will consider whether the water companies' policies are reasonable.

When the work has been completed, water companies should review how much security they are holding and the level of risk that remains. Where appropriate, companies should then return excess security to the requisitioner at this stage. They should pay interest on any security they hold for the length of the time they hold it in accordance with the rates we issue – see chapter 10 for more information.

Principle 12: When a water company requires security for self-laid works, this should cover the reasonable potential cost of remedying minor defects in the SLO's work and the reasonable costs of the non-contestable work, where these have not already been recovered.

Principle 12a: This security should be held until the SLO has paid the charges for the work that has been carried out and the defects liability period or maintenance period is over.

Water companies will not adopt any self-laid pipes unless they have been installed to the required standards. For this reason, the risk to the company of having to remedy defects should be low. The cost of this should not be as high as the overall costs of installing the new mains. Where water companies ask for higher levels of security, they should be able to justify and precisely quantify why additional security is required. We can look at disputes about deposits and security.

Where appropriate, we would encourage companies to return the deposit to the developer in staged payments. This is to reflect the reduction in the companies' risk.

7. Supplies for non-domestic purposes

Principle 13: Water companies should consider developers' requests to self-lay non-domestic supplies. Water companies do not need to make an asset payment for self-laid mains for wholly non-domestic purposes.

Supplies for non-domestic purposes are for purposes other than those defined as domestic purposes in WIA91. Principle 3 explains the definition of supplies for domestic purposes. It is important to note that many non-residential developments use water as defined under section 219 of WIA91. In these circumstances, we expect water companies to make asset payments where the water is being used for domestic purposes. WIA91 does not prevent companies from agreeing to take responsibility for a main that has been installed, in whole or in part, for non-domestic purposes.

Under section 51A(2) of WIA91, water companies should allow developers to choose their own contractor to lay mains to supply water for non-domestic purposes and agree to take responsibility for the pipes once the work is completed to the required standard. The pipe will be vested in (adopted by) the water company in the same way as under an agreement to adopt self-laid pipes supplying water for domestic purposes.

Section 56 of WIA91 states that when a developer asks a water company to supply water for non-domestic purposes, the company is entitled to recover its expenses and, where appropriate, a reasonable return on its capital. The water company does not have to make an allowance for the future revenue that will be received from customers connected to that main. So, when a developer lays a main for solely non-domestic purposes, the water company does not need to make an asset payment.

Frequently, a developer may require a supply for both domestic and non-domestic purposes. If the developer lays a main for both purposes, the water company should make an asset payment in respect of the proportion of the supply that is for domestic purposes.

8. Installing new sewers

8.1 Charges for installation of new sewers by the sewerage company

Sewerage companies should calculate requisitioning charges based on the following.

- (a) Under section 43(2) of WIA91, sewerage companies are entitled to recover the costs reasonably incurred in providing the new sewer. This includes, among other things, the reasonable costs of design, labour, plant, materials, reinstatement, quality testing, inspection, supervision and administration costs. This amount should not include any allowance for profit. WIA91 does not allow sewerage companies to make a profit on their charges for this work.
- (b) Section 100(4)(a) of WIA91 also provides that sewer requisitioning charges can include any costs reasonably incurred in providing other public sewers and such pumping stations necessary in consequence of the provision of the new sewer. These costs are often referred to as network reinforcement.
- (c) Under section 100(4)(b) of WIA91, the sewerage company can also charge the requisitioner a reasonable proportion of the costs reasonably incurred in providing additional capacity in existing sewers that were previously requisitioned, where this is used because of the new sewer.
- (d) The sewerage company will also have to provide lateral drains if the requisitioner asks. The costs of this work can be recovered in the same way.

8.1.1 Relevant deficit charges

Section 100(1) of WIA91 states that the relevant deficit charge for sewer requisitions is defined as the amount (if any) by which the drainage charges payable for the use during the year of that sewer are exceeded by the annual borrowing costs of a hypothetical loan of the amount required to provide the sewer.

The relevant deficit charge is calculated using broadly the same methodology as for water main requisitions, but takes into account the drainage charges that will be received from newly-connected properties. When a sewer is requisitioned, whether this is on-site or off-site, sewerage companies should take account of the revenue that will be received from newly-connected properties.

8.1.2 Payment by statutory commuted sum

Under section 100A of WIA91, the statutory commuted sum payment is calculated using a similar methodology as for water main requisitions.

8.1.3 Infrastructure charges

Infrastructure charges are also payable for sewerage services. See chapter 9 for more information.

8.2 Principles for calculating charges for installing sewers

The principles that sewerage companies should follow when calculating the components of requisitioning charges are outlined below.

Principle 14: Sewerage companies' estimates of relevant deficit and statutory commuted sum charges for sewer requisitions should be based on robust information and calculated consistently.

- Developers may benefit if they provide timely and accurate information to enable sewerage companies to provide accurate estimates.
- Estimates of revenue should be based on the average sewerage charge for each property.

Under section 100(7) of WIA91, the drainage charges that sewerage companies should consider when calculating requisition charges are those relating to the premises connected to the sewer and are reasonably attributable to the use of that sewer for domestic sewerage purposes or the disposal of effluent from those premises. The assessment of future revenue does not need to take account of charges for trade effluent or highway drainage.

Principle 15: Principles 4-8 relating to the calculation of charges for requisitioning water mains should be applied to the calculation of sewer requisitions charges.

These principles apply, taking into account the following comments.

- The relevant deficit should be calculated on the basis of revenue payable, not the revenue received from a connected property.

- The discount rate that sewerage companies use should be the same as the interest rate for borrowing, which is explained further in chapter 10.
- Sewerage companies should forecast the long-term effects of inflation and K on anticipated revenue when calculating the statutory commuted sum.
- Sewerage companies should use developers' submissions to assess when income starts to become payable for a property.

Principle 5 applies to sewers in a slightly different way, as follows.

- Sewerage companies should allocate 100% of the sewerage charges for connected premises as the income allowance, where this is not income for trade effluent or highway drainage.

Principle 16: When calculating the charges for self-laid sewers, sewerage companies should not pay developers an asset payment.

If the developer decides to lay sewers under section 104 of WIA91, for connection direct to an existing public sewer, the sewerage company cannot recover a charge for network reinforcement. As a result, it would not be possible to calculate the income allowance consistently.

Principle 17: When sewers are requisitioned and the sewerage company requires security, the sewerage company should ask for no more than 100% of the estimated statutory commuted sum unless there are justifiable reasons for doing so. If a water company requests a security or undertaking greater than the estimated statutory commuted sum, it should provide full justification at the time of making the request.

In some circumstances, it may be reasonable for sewerage companies to require extra security, or to hold on to the security after the relevant deficit has reached zero or the statutory commuted sum has been paid. In these cases, sewerage companies should state clearly their policies and the increased costs the requisitioner will incur. Under section 99(6) of WIA91, sewerage companies are entitled to ask for security before installing new sewers in response to a requisition. We have powers to determine disputes about the security that a sewerage company requires. If any dispute about the level of security is referred to us, we will consider whether the sewerage companies' policies are reasonable.

When the work has been completed, sewerage companies should review how much security they are holding and the level of risk that remains. Where appropriate, companies should return excess security to the requisitioner at this stage, applying the appropriate level of interest.

9. Infrastructure charges and network reinforcement costs for water main and sewer installation

Principle 18: When considering disputes about the level of charges for network reinforcement we will take account of the infrastructure charges that have been or will be raised for that development.

Water and sewerage companies can recover only the actual costs they have incurred from developers in servicing the relevant development.

9.1 Network reinforcement

Section 43(4)(a) of WIA91 states that water requisitioning charges can include any costs reasonably incurred in providing other water mains and any tanks, service reservoirs and pumping stations necessary because of the provision of the new main.

Under section 100(4)(a) of WIA91 also provides that sewerage requisitioning charges can include any costs reasonably incurred in providing other public sewers and any pumping stations necessary because of the provision of the new sewer.

These costs are commonly known as network reinforcement. Under WIA91, we have the powers to determine disputes about the reasonable levels of requisitioning charges, including costs of network reinforcement relating to either water or sewer requisitions. In considering these disputes, we will want to look at water and sewerage companies' data in support of their claims for network reinforcement costs, such as:

- modelling of the supply zone or sewer catchment showing the estimated effects of the proposed development on the adequacy of the infrastructure to supply or drain to existing and new customers;
- any evidence indicating inadequate capacity in the existing distribution network to supply the new development. For example, we could refer to complaints about low pressure from existing customers or properties on the DG2 register (properties at risk of low pressure). This is the register of low pressure indicators that water companies must report on;
- any evidence of inadequate capacity in the local sewerage system to drain the new development. For example, we could refer to complaints of sewer flooding in the vicinity or existing properties on the DG5 register (properties at risk of internal sewer flooding); and

- if network reinforcement applies to two or more developers, an explanation and breakdown of how the costs are apportioned between each developer.

If the water or sewerage company upgrades a main or sewer to take account of anticipated future developments, it can only recover the costs from the developer specifically associated with the network reinforcement relating to the current development.

If a water or sewerage company has previously enhanced the water supply network or sewerage service in response to a statutory requisition in the previous 12 years and provided additional capacity used by the new main or sewer, the company may recover from the developer the appropriate proportion of the costs of that network enhancement. (A water company can also recover an appropriate proportion of any costs it incurred in paying a developer to provide additional capacity in a self-laid main vested in the water company by virtue of a declaration under chapter II of part III of WIA91.)

9.2 Timescale for recovery of costs

Water and sewerage companies may only recover the costs of work **necessary** to reinforce the network. For small developments we think it is unlikely that any such work would be carried out more than a year after the self-laid main or requisitioned main or sewer has been installed. There may be circumstances where a large site is developed in phases and infrastructure is therefore requisitioned (or, in the case of water mains, self-laid) in stages. The network reinforcement could be necessary at the first stage or at a later stage (which could be one or more years later) as a result of another requisition (or self-lay installation).

In determining relevant disputes, we will consider carefully whether the network reinforcement was necessary, particularly where water or sewerage companies seek to recover the costs of reinforcement that took place more than a year after the main or sewer had been installed.

9.3 Infrastructure charges

Section 146(2) of WIA91 entitles a water or sewerage company to raise a charge where connections for water supplies or sewerage services for domestic purposes are made for the first time to premises. This is regardless of who carries out the work and is known as the infrastructure charge. When we set price limits we consider infrastructure charges as a contribution to the costs of enhancing the local network of

mains and sewers. The Director set the infrastructure charge limit for a standard connection at £200 at the 1995 periodic review and it has subsequently increased in line with inflation. In RD 2/95, 'Infrastructure charges' (January 1995), we said that infrastructure charges are a contribution towards the costs of local system enhancement (ie the distribution system) only, and should not therefore be financing the costs of, for example, water treatment or water resources.

We will take account of infrastructure charges payable for premises on the relevant development when considering costs reasonably incurred for network reinforcement.

When we consider disputes, we will require water or sewerage companies to explain any costs they have incurred in installing infrastructure that they have not recovered through infrastructure charges. This is to ensure that there is no double recovery of costs for new infrastructure. We expect the companies to recover full costs for any reinforcement work.

10. Interest rates for requisitioning – borrowing and deposits

The interest rates for borrowing and deposits are linked to the ten-year gilt yield. We add premiums to this figure to calculate the rate of interest for borrowing and deposits. The premiums we assume will stay the same until the outcome of the current price review. At that point, we will then review the level of premiums that we should apply. We will continue to notify the industry of changes in interest rates by issuing RD letters. We will not ask for changes to be applied retrospectively.

11. Charging for new infrastructure when a new licensee enters the market

The Water Act 2003 (WA03) also creates a framework for companies that want to compete with existing water companies to supply non-household customers who use at least 50 megalitres of water a year (Ml/yr) through the water supply licensing (WSL) regime.

The developer of a new site may go to tender for the provision of water and/or sewerage services to the site. The developer may receive offers from incumbent water and/or sewerage companies, and actual/potential inset appointees. Upon [appointment](#), inset appointees become subject to the same rights and responsibilities as all water and/or sewerage undertakers. In this guidance, references to water companies are therefore also references to inset appointees. Where a developer chooses a potential inset appointee as its preferred bidder, the developer may requisition infrastructure from the appointee upon appointment. An inset appointee may arrange for the provision of infrastructure on a self-lay basis, and in doing so is subject to the same self-lay framework guidance and duties as all water and/or sewerage undertakers.

A water supply licensee's (licensee) customer can requisition water mains to provide supplies for domestic purposes if they are owners or occupiers of premises in a locality. The water company will still need to calculate the revenue for the purposes of calculating the relevant deficit or commuted sum. If it is a licensee's customer that is requesting a requisition, sections 43(7) and 43A(4) of WIA91 state that this calculation should recognise that the water company's charges for the supply of water will be different from the charges recovered from its own customers.

If the water company is aware that customers supplied by a requisitioned main will shortly be switching to a licensee, it can take account of this when estimating revenue for the purposes of calculating the charges and payments for new infrastructure. The water company would still need to be able to demonstrate that the customer is switching. (In calculating relevant deficits, water companies will be able to take into account what has **actually** occurred.)

Appendix 1: Template of non-contestable costs

For work carried out by the water company when a developer or SLO lays water mains and service pipes

This table lists the costs for the work that the water company will insist on carrying out and the quotations for relevant deficit and commuted sum charges and payment for asset.

Site:.....

Date:.....

Item no.	Description of tasks	Details	Costs
	On-site works		
a)	Approval of designs of on-site works produced by the developer/SLO		
b)	Diversions ¹		
c)	Wayleaves or easements		
d)	Inspection and supervision of contestable work		
e)	Connection to water company's existing network		
f)	Water sampling and quality analysis		
	Off-site works		
g)	Design of off-site works		
h)	Off-site diversions		
i)	Wayleaves or easements		
j)	Inspection and supervision of contestable work		
k)	Connection to water company's existing network		
l)	Water sampling and quality analysis		

Note:

1. Our guidance, 'Competition in providing new mains and service pipes' states that companies should allow SLOs to carry out the new part of diversions to new development sites where SLOs have the necessary permissions and no existing customers will be affected, and/or there are no engineering reasons why this work should be non-contestable.

Charges quotations

Item no.	Payment	Amount
n)	Charge for network reinforcement	
o)	Infrastructure charges	
p)	Estimated statutory commuted sum charge	
q)	Estimated payment for asset	

Appendix 2: Contestable and non-contestable work

Contestable work

- Installing on-site mains.
- Installing off-site mains in third party land and highways where SLOs have obtained the necessary easements, street authority approvals and satisfied any other legal requirements.
- Installing extensions and the new part of diversions to new development sites, where SLOs have the necessary permissions and no existing customers will be affected and/or there are no engineering reasons why this work should be non-contestable.
- Designing on-site water systems in accordance with water companies' specifications.
- Installing water meters.
- On-site connections.
- Connecting service pipes to existing off-site mains subject to the appropriate accreditation.
- Installing service pipes to water company specifications.
- Connecting service pipes to new mains (after the water company has filled the new mains with water), provided the appropriate standards are met and there are no risks to existing customers. See also the guidance on timing of service pipe connections.
- Swabbing, pressure testing and disinfecting new mains, under supervision.

Non-contestable work

- Off-site work to reinforce the existing network.
- Approving on-site water system designs.
- Designing off-site water systems.
- Determining the timing of service pipe connections to new mains.
- Connections that involve risks to existing customers.
- Water sampling and quality testing.

Appendix 3: Regulatory impact assessment

Purpose

The Water Act 2003 (WA03) amends the Water Industry Act 1991 (WIA91) and creates a new regime for calculating payments and charges for installing new infrastructure and handling disputes about the terms and conditions of self-lay and requisitioning agreements. The relevant provisions came into effect on 28 May 2004.

In December 2003, we issued the following consultation papers outlining the self-lay and requisitioning provisions of WA03 and proposing a framework for implementing these.

- 'Financial arrangements for self-lay and requisitioning agreements' (the financial consultation).
- 'Process for handling disputes and appeals' (the disputes consultation).

These consultations included the draft regulatory impact assessment (RIA) which covered how the water and sewerage sectors will be affected by implementing the new framework outlined in the guidance documents. We asked stakeholders to comment on our view of the impact of our guidance on the industry.

We have now considered the responses to the draft RIA. On the basis of the responses to the draft RIA, we have not changed our assessment of the impact on the sectors in the final RIA or the approach that we set out in our guidance documents.

Proposals in the draft RIA

In the draft RIA, we set out three options for implementing the new regime.

1. Do nothing. There is no statutory requirement for us to produce guidance on these issues.
2. Propose a set of principles for the water and sewerage sectors to follow when calculating the charges and payments that will be made when works are requisitioned.
3. Prescribe the levels of the charges and payments they should make.

We felt that the risk of following option 1 was that water and sewerage companies may miscalculate payments or implement a variety of policies which would create

inconsistency across the industry. This may generate a high number of complaints and have a detrimental effect on the market for installing new infrastructure.

Option 3 leaves no flexibility for water and sewerage companies to decide their own policies and may increase the costs to us of implementing the regime. Overall, we prefer option 2, as we consider this will enable water companies to implement the proposals in WA03 effectively, including developing their internal policies and procedures where necessary.

Response to the draft RIA

We received more than 35 responses to these consultations and about one-sixth of respondents commented specifically on the draft RIA. These comments are summarised in our document, [‘Consultation on financial arrangements for self-lay and requisitioning agreement: Summary of responses and our conclusions’](#). In general, respondents felt that our estimates of the impact on the industry on the new regime were reasonable, although it will be easier to judge this once the final guidance is published.

We will monitor the implementation of the legislation around the industry and review whether the RIA still applies.

Our assessment of the benefits and costs to the industry follows.

Benefits

The new framework will affect an average of 175,000 new connections to the water and sewerage distribution system each year. The Department for Environment, Food and Rural Affairs (Defra) estimates that the value of the relevant market is between £100-160 million each year.

We see the following benefits in producing the guidance documents.

Benefits to water and sewerage companies

- It enables water and sewerage companies to plan policies to implement WA03 more effectively and to decide a business strategy in relation to the self-lay market.

- It reduces uncertainties for water and sewerage companies, by explaining when we will intervene in disputes or appeals and the information we expect from the parties to the disputes or appeals.
- It enables water and sewerage companies to reduce some costs in the long term as they will be aware of the principles that they should follow when deciding policies, and the information we will require when we investigate disputes or appeals.
- It requires water and sewerage companies to improve the efficiency of their procedures, particularly with regard to estimating costs, issuing quotations and responding to disputes or appeals.

Benefits for developers and other customers

- It gives developers greater choice in installing new infrastructure and the ability to influence the timetable for water and sewerage companies carrying out works.
- It provides clarity, enabling developers to take advantage of new opportunities in the market. It enables developers to make reasoned comparisons of the costs of requisitions and self-lay options so they can make an informed choice between the available options. This will strengthen the market and reduce complaints. Developers will be the main beneficiaries of the new legislation but may pass savings on to house buyers.

Benefits for us

- Setting out a clear framework understood by all parties to the dispute or appeal enables us to handle cases more efficiently and should reduce the number of complaints we receive in the longer term.
- Our approach improves the transparency of regulation.

Costs

The expected costs are split into two categories: costs that the water and sewerage companies and developers will have to finance and the expected costs for us.

Compliance cost to the industry

- There will be the ongoing costs that the water and sewerage companies incur in implementing policies that meet the principles set out in the final guidance. The water and sewerage companies may have to incur costs anyway when the provisions of WA03 come into force to ensure that they are complying with the new legislation. The principles in the final guidance enable water and sewerage

companies to focus on any changes they need to make in their policies. This will help them increase efficiency and reduce costs.

- Clarifying the financial arrangements may generate marginal additional costs for developers. Any costs are likely to be outweighed by the benefits arising from a transparent regime, including competitive charges and improved efficiency. We expect the generality of the new or existing customer base to subsidise these marginal additional costs.
- There may be a charge to water and sewerage companies and/or complainants for handling disputes that are referred to us. This will partly replace the costs currently incurred in pursuing these disputes already. The industry already incurs costs in responding to developers' complaints and should not have to produce any significant new information for us to deal with disputes or appeals.

Compliance cost to Ofwat

- We incurred minimal costs for preparing the consultation paper and final guidance, and in running a workshop in January 2004 to present key points from this consultation to the industry.
- We will incur costs in handling a new range of disputes about terms and conditions of self-lay agreements, and requisitioning disputes. There will be staffing implications for this new work. We will also incur costs in obtaining external advice. We expect our costs of dealing with disputes will reduce over time as water companies and developers take into account early determinations and refine their policies accordingly. We estimate that the cost to us of handling disputes referred under the new regime will be £50,000 a year. This figure will be reviewed in the light of our experience in handling disputes or appeals. We intend to recover some or all of our costs incurred in dealing with disputes or appeals from water companies and developers.

Monitoring and review

We will review the RIA when we next review the financial guidance. The SLG is considering its role in monitoring the implementation of the legislation around the country.



Ofwat, Centre City Tower
7 Hill Street, Birmingham B5 4UA

Phone: 0121 625 1300 Fax: 0121 625 1400
Website: www.ofwat.gov.uk
e-mail: enquiries@ofwat.gsi.gov.uk

August 2008

© Crown Copyright 2008