

Consultation on the financial arrangements for self-lay and requisitioning agreements

1 Purpose

When a new water main or sewer is needed, the body requiring the new services can ask the water and/or sewerage undertaker¹ to install the pipework. Alternatively, they may choose their own contractors to carry out the work – known as ‘self-lay’. When the relevant clauses come into effect, which is likely to be in spring 2004, the Water Act 2003 (WA03) will amend the provisions of the Water Industry Act 1991 (WIA91) that relate to installing new water mains, service pipes and sewers. It recognises the need for water and sewerage undertakers to safeguard the quality of supplies and service.

This consultation paper explains what effect the new legislation will have on installing new pipework. It invites comments on the principles that we think water and sewerage undertakers should follow in calculating charges and payments for this work. We are seeking views on our proposals.

The amended WIA91 will give us the power to determine disputes about the terms and conditions of self-lay and requisitioning agreements. Our proposed process for handling these disputes is set out in our consultation on ‘Process for handling disputes and appeals’.

Once this consultation is complete we will publish final guidance, alongside our final guidance on the ‘Process for handling disputes and appeals’, to coincide with the commencement of the new legislation. These documents will supplement our existing guidance on ‘Competition in providing new water mains and service pipes’ (the self-lay guidance).

1.1 Scope of the consultation

When a new water supply or sewer is required for domestic purposes, asking a water or sewerage undertaker to install the pipework is called requisitioning. Either the owners or occupiers of premises in that locality – this can include developers – or the local authority can make a requisition.

The person who requisitions the main or sewer (the requisitioner) is required to pay the water or sewerage undertaker for the work that is involved in constructing the new pipework. There is a mechanism in the WIA91 for calculating the requisition charges. This requires requisitioners to make yearly payments to water and sewerage undertakers for up to 12 years and is known as the relevant deficit option. This is explained further in section 4.1. Water and sewerage undertakers can offer requisitioners the option of paying in a single payment, but are not obliged to do this. The amended WIA91 will require water and sewerage undertakers to offer this payment option.

¹ An undertaker is a company holding an appointment as a water and/or sewerage undertaker for the purposes of the WIA91.

The amended WIA91 will also formalise the arrangements for persons other than water undertakers to lay water mains, and service pipes to the boundary of the highway in which the main lies. Under the new legislation, water undertakers will be able to enter into agreements with persons constructing or proposing to construct new water mains and service pipes (a self-lay agreement). If a self-lay organisation (SLO) installs pipes to supply water for domestic purposes, and the pipes are constructed in accordance with the terms of the agreement, the water undertaker will have to connect the pipes to the existing network and take over responsibility for (adopt) the pipes. Water undertakers will then have to make a payment to SLOs for water mains that the SLOs have installed and the water undertaker has adopted.

The first part of this paper is mainly about how the new provisions relate to charging for installing new infrastructure to supply water for domestic purposes.

There is no specific provision covering the installation of pipes by SLOs to supply water for non-domestic purposes. But under the new provisions, a water undertaker can agree to take responsibility for these pipes if a third party lays them. This is explained in section 8.

The impact of the new legislation on the calculation of charges for requisitioning new sewers is explained in section 9. Developers are already able to self-lay sewers² and this is supported by a self-lay policy in the publication 'Sewers for adoption'. This is a guide developed jointly by the WRc and the sewerage undertakers of England and Wales. It sets out the standards that developers should follow when designing and constructing sewers to adoptable standards.

On a separate issue, section 11 of this paper suggests alternatives to the present method of calculating the rates of interest on borrowing and deposits.

The WA03 will introduce an enabling power for the Secretary of State or the National Assembly for Wales to make Regulations under which the sewerage undertakers will adopt sewers, lateral drains and sewage disposal works. However, the Government has not yet made any decisions about the best way forward on private sewers. This consultation does not relate to this issue.

We are aware of the sustainable communities initiative, especially in the Thames Gateway area. We are liaising with Defra and ODPM about the impact of this legislation.

This document is not a substitute for the WIA91 and the WA03 or any other relevant legislation. It should be read in conjunction with the legislation. Anyone in any doubt about how the legislation may affect them should seek independent legal advice.

² See Section 104 of the WIA91.

1.2 The need for guidance

The amended WIA91 will provide a formal framework for self-lay, providing opportunities for developers, SLOs and water undertakers. In addition, we will have a new role in handling disputes about self-lay and requisitioning agreements. We want to deliver a regime that reduces uncertainties for everyone. We want the water and sewerage undertakers to develop reasonable policies and reduce the number of complaints. This will enable us to streamline how we handle the disputes that we receive.

The final guidance document will explain the financial arrangements that we expect water and sewerage undertakers to follow when reaching agreement with requisitioners or SLOs about requisitioning or self-lay arrangements. We will refer to the policies set out in the guidance when we consider disputes under our new powers.

1.3 The basis of the consultation

In March 2002, we issued the self-lay guidance. This was a non-statutory framework outlining the self-lay policies that water undertakers should have in place. Most water undertakers now comply with this guidance.

When we issued the self-lay guidance we asked all water undertakers to revise their policies in the light of the recommendations that we made. We have reviewed these policies and they have informed this consultation. We have also discussed the issues covered with SLOs and water and sewerage undertakers, and our industry advisory group – the self-lay group (SLG). The SLG comprises representatives from water and sewerage undertakers, developers, contractors and regulators. It was set up in May 2002 to provide a forum to facilitate opening up the self-lay market to competition. The current membership of the SLG is included in annex 1.

2 The principles

We have identified 19 principles that should underlie financial arrangements between water and sewerage undertakers and developers when they are requisitioning new water mains or sewers, or self-laying new water mains. These are set out below and in bold, from section 5.4 to section 10 where the technical detail of the proposals is set out. We would like to hear your views on these principles.

Draft principle 1: Water undertakers' estimates of relevant deficit and commuted sum charges for water mains and asset payments for self-laid water mains, must be based on robust information about the anticipated costs of the work. Developers must provide timely and reliable information about the work that is needed for water undertakers to provide estimates that are as accurate as possible.

Draft principle 2: When calculating the annual borrowing costs in order to calculate the asset payment, water undertakers must use the same overall costs figure as they use to estimate the relevant deficit or the commuted sum.

Draft principle 3: Water undertakers must estimate the rate of connection and the income allowance in the same way whether they are calculating the asset payment, or quotations for commuted sum or relevant deficit charges.

Draft principle 4: All estimates of revenue must be calculated on the basis of the average metered consumption per property. Estimates must take account of the different property sizes as well as the future revenue from supplies for non-domestic purposes, where this can be assessed.

Draft principle 5: The relevant deficit must be calculated on the basis of the revenue that is payable or billed, not the revenue that has been received from a newly connected property.

Draft principle 6: Water undertakers must allocate 100% of the revenue from newly connected premises as the income allowance.

Draft principle 7: The discount rate that water undertakers use must be the cost of capital allowed for in their price limits.

Draft principle 8: Water undertakers must forecast the long-term effects of inflation on anticipated revenue when calculating the commuted sum charge or the asset payment.

Draft principle 9: Water undertakers must rely on a combination of their own data and methodologies and the developer's submissions about build rate to estimate the rate of connection of properties.

Draft principle 10: Water undertakers must complete a costs breakdown template for each job, including all the costs of non-contestable elements of self-lay work and the quotations for commuted sums and asset payments.

Draft principle 11: Water undertakers must not insist that security be provided in one particular form but must offer a choice of payment methods to the developer.

Draft principle 12: When works are requisitioned and the water undertakers require an undertaking, the water undertaker must ask for no more than 100% of the estimated commuted sum. This must be returned when the relevant deficit becomes zero, and will remain zero, or when the final commuted sum is paid.

Draft principle 13: When works are self-laid, and the water undertakers require security, this must cover the costs of the non-contestable work that the water undertakers will carry out and the potential cost of remedying defects in the SLO's work. It must be held until the SLO has paid the charges for this work and the water undertaker has taken over responsibility for the work.

Draft principle 14: Water undertakers must consider developers' requests to self-lay non-domestic supplies. Water undertakers do not need to make an asset payment for self-laid mains for non-domestic purposes.

Draft principle 15: Sewerage undertakers' estimates of relevant deficit and commuted sum charges for sewer requisitions must be based on robust information and calculated consistently. Developers should provide timely and accurate information to enable sewerage undertakers to provide these estimates. Estimates of revenue must be based on the average sewerage charge per property, taking account of the different property sizes where appropriate.

Draft principle 16: Principles 5 – 9, relating to the calculation of charges for requisitioning water mains, must be applied to the calculation of sewer requisitions charges.

Draft principle 17: When calculating the charges for self-laid sewers, sewerage undertakers should not pay developers an asset payment.

Draft principle 18: When sewers are requisitioned and the sewerage undertaker requires security, the sewerage undertaker must ask for no more than 100% of the estimated commuted sum.

Draft principle 19: 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.

In the final section of the paper, we have outlined proposals for calculating the rates of interest on borrowing and deposits. We welcome your views on this.

3 Responding to the consultation

Please mark your responses 'self-lay' and send them by 12 March 2004 to:

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If you wish to discuss any aspect of this paper, please contact Sarah Thomas on 0121 625 1353.

Unless otherwise requested, all responses will be placed in the Ofwat library and made available to the public.

4 Charging framework for water infrastructure

4.1 Charging for water main requisitions

When mains are requisitioned, water undertakers are entitled to recover the costs of installing the new mains by charging the requisitioner the relevant deficit. This 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 main³.

The annual borrowing cost of a loan for the cost of providing a new main is the total amount of interest and repayments of capital which would have to be paid in any year.

The WIA91 also specifies how revenue must be treated when calculating charges for new water infrastructure. In this document, we use the term revenue to mean the water undertaker's total annual income from customers connected to a new main (or sewer – see section 9).

The revenue that can be taken into account when calculating a relevant deficit charge for water mains is as much of the water undertaker's charges that year as are reasonably attributable to providing a supply of water for both domestic and non-domestic purposes to those premises using the new main⁴.

The water undertaker charges the requisitioner the relevant deficit to make up the difference when the revenue is insufficient to meet the costs of financing the provision of the new main over a 12-year period. The water undertaker is not required to make a payment to the requisitioner when the revenue from the newly connected premises exceeds the cost of financing the new main. At this point, the relevant deficit becomes zero. Because the revenue is capped in this way, the allowance that is made for revenue when calculating the charges for requisitioning will not equal the actual revenue received if the actual revenue is higher than the annual borrowing cost of a loan. So the level of revenue that is used to calculate requisitioning charges and asset payments, is referred to in this document as the income allowance.

³Section 43(1) of the amended WIA91.

⁴See section 43(7) of the amended WIA91.

However, many requisitioners do not wish to be tied into financial arrangements for 12 years, preferring to make a single payment when the main is provided. There are also administrative advantages to paying for sewers or mains in this way. This payment is referred to as the fixed lump sum; the discounted aggregate deficit; the lump sum contribution or the commuted sum. We use the term commuted sum. Currently water undertakers calculate the commuted sum inconsistently.

1) Changes made by the Water Act 2003

The new provisions will formalise the calculation of the commuted sum⁵. The amended WIA91 will state that the commuted sum will be the 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 value⁶.

4.2 Asset payments for self-laid mains

In the self-lay guidance we stated that the water undertakers should pay an asset value to SLOs when they take over responsibility for self-laid mains to recognise that these assets will generate revenue. The payment should be consistent with the income allowance that the water undertaker would have made when calculating its requisitioning charges. However, not all water undertakers follow these guidelines. As a result, there are several different methods of calculating the asset payment, and these payments may or may not equal the income allowance.

1) Changes made by the Water Act 2003

The amended WIA91 will state that water companies must make an asset payment⁷ to SLOs who install their own pipes. This amount will be 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 value⁸. So this will be equivalent to the income allowance that is made when calculating requisition charges, discounted to a net present value.

⁵ This is referred to in the amended WIA91 as the discounted aggregate deficit.

⁶ Section 43A(1) of the amended WIA91.

⁷ In the amended WIA91 this is referred to as the discounted offset amount.

⁸ Section 51C(6) of the amended WIA91.

5 Calculating the charges for requisitioning and asset payments

5.1 Relevant deficit and commuted sum for water mains

Relevant deficit, for any one year	=	Annual borrowing cost of financing a new main, comprising the interest payments on the loan and repayments of the capital costs of construction. Minus Income allowance, as much of the water undertaker's charges in relation for premises connected to the new main, as are attributable to providing a supply of water (for domestic or non-domestic purposes) to those premises.
Where the revenue is equal to or greater than the annual borrowing costs the relevant deficit is zero.		

Under the amended WIA91, the commuted sum will be calculated as follows.

Commuted sum	=	Yearly estimated relevant deficit X Discount rate (to discount to net present value) for each of 12 years.
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5.2 Asset payments

Under the amended WIA91, the payment for the asset will be calculated as follows.

Total asset Payment	=	Yearly income allowance X Discount rate (to discount to net present value) for each of 12 years.
Where the relevant deficit would be zero, the income allowance for that year will be equal to the annual borrowing costs. See worked example at annex 2.		

In order to calculate the relevant deficit, commuted sum and the asset, the water undertaker will need to know or estimate:

- the cost of installing the new infrastructure;
- the level of revenue per newly built property that it will receive from the new development in each year; and
- the number of properties that will be built in the new development (or the build rate) and the dates when properties will be completed.

To calculate the commuted sum and the asset payment, the water undertaker will also need to know the discount rate. These issues are explained in more detail below.

5.3 The costs of installing new infrastructure

The WIA91⁹ states that the requisition charge for installing new mains is based on the costs reasonably incurred in providing that main. These costs include the cost of the work involved in digging trenches, laying pipes, connecting the pipework and quality testing. It could also include network reinforcement costs, which are the costs of any additional necessary work further upstream that companies can recover under section 43 of the WIA91.

Where additional capacity in an existing main is used because of the new main, the water undertaker can charge the requisitioner a reasonable proportion of the costs reasonably incurred in providing the additional capacity in the earlier main.

All of the water undertaker's costs for installing the mains, including supervision and/or inspection, are included when calculating the relevant deficit or commuted sum. However, requisitioning costs do not include the costs of enhancing assets other than those specified in section 43 of the WIA91. These are funded through the water undertaker's capital investment programmes, paid for through general water charges.

Requisitioning costs 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 lays). The costs associated with making these connections such as supervision, materials, costs or inspection must not be included. Although this work is frequently carried out at the same time, there are separate mechanisms for recovering these costs and for resolving disputes about the charges¹⁰. Similarly, the requisitioning costs do not include the costs of any pipe diversions that the water undertaker has been asked to make under section 185 of the WIA91, which water undertakers can recover separately.

The relevant deficit must be calculated on the basis of the actual costs incurred in installing pipes. The water undertaker should also use these costs to calculate the commuted sum charge which becomes payable when the work is completed.

5.4 Estimating the costs of the work

⁹ Section 43 of the amended WIA91.

¹⁰ Section 45 of the WIA91.

Draft principle 1: Water undertakers' estimates of relevant deficit and commuted sum charges for water mains and asset payments for self-laid water mains, must be based on robust information about the anticipated costs of the work. Developers must provide timely and reliable information about the work that is needed for water undertakers to provide estimates that are as accurate as possible.

Water undertakers will need to estimate the relevant deficit or commuted sum charges to provide quotations before the works start. This will involve making an assessment of the likely costs of the work. When the asset payment is calculated, it will be based on notional costs, including estimates of the overall borrowing costs of the work.

Water undertakers' estimates need to be robust. Water undertakers are entitled to recover the reasonable costs of the work, which means that they are not obliged to recover only the estimated costs for the work if they are lower. If a water undertaker underestimates the requisition charges, then the developer may decide not to self-lay and instead ask the water undertaker to carry out the work. The water undertaker may then revise the charge upwards after the work has been carried out. We would be concerned if a water undertaker deliberately discouraged competition from SLOs, for example by deliberately underestimating commuted sums. This would have a detrimental effect on competition in the market.

Water undertakers use several different methods for estimating the cost of installing new mains. Some water undertakers use a standard average cost per unit, for example per unit length or per property. Other water undertakers compile and maintain databases of information to use when issuing quotations. By operating a standardised system for estimating overall costs, there will be savings in time and administration. However, water undertakers must ensure that this information is in line with their actual contractual costs, which must reflect reasonable market rates.

5.5 Estimating the costs of the work to calculate the asset payment

Draft principle 2: When calculating the annual borrowing costs in order to calculate the asset payment, water undertakers must use the same overall costs figure as they use to estimate the relevant deficit or the commuted sum.

The amended WIA91 will state that the income allowance will be calculated as if the main had been requisitioned¹¹. So, when calculating asset payments, water undertakers will have to estimate the annual borrowing costs by referring to the same level of overall costs that they estimate they would have reasonably incurred in providing the main had it been requisitioned.

The figure for the overall costs used in calculating the annual borrowing costs will include the actual costs of the work that the water undertaker must carry

¹¹ Section 51C(8) of the amended WIA91.

out (the 'non-contestable' work), plus a notional figure for the cost of the work that the SLO carries out. The total overall costs should not differ from the water undertaker's own estimates of how much it would have cost it to install the main. See worked example at annex 2.

5.6 Consistency in estimating components of calculations

Draft principle 3: Water undertakers must estimate the rate of connection and the income allowance in the same way whether they are calculating the asset payment, or quotations for commuted sum or relevant deficit charges.

Water undertakers must estimate the components of charges for requisitioning and the calculation of the asset payment in the same way otherwise the developer will not be able to compare the cost of self-lay against the price of requisitioning.

5.7 Estimating the revenue

1) Basis of estimating annual bills

Draft principle 4: All estimates of revenue must be calculated on the basis of the average metered consumption per property. Estimates must take account of the different property sizes as well as the future revenue from supplies for non-domestic purposes, where this can be assessed.

Estimates of future revenue must be robust. If developers provide water undertakers with information about the sizes of the properties that they are building, water undertakers must take account of it when estimating the future revenue from newly connected mains.

Under the amended WIA91¹², the calculation of the relevant deficit and commuted sum will take into account the revenue that the water undertaker will receive in connection with providing a supply to the newly connected premises whether or not that supply is for domestic purposes. So if the undertaker is aware of connections for the supply of water for non-domestic purposes that will be made to the newly installed mains in the future, the revenue from these supplies should also be taken into account when estimating the revenue and calculating the income allowance.

2) Estimating the revenue that will be billed

¹² Section 43A(4) of the amended WIA91.

Draft principle 5: The relevant deficit must be calculated on the basis of the revenue that is payable or billed, not the revenue that has been received from a newly connected property.

When the relevant deficit is calculated, the revenue that is due from the new properties will be known. But it is important to note the distinction between what the newly connected premises are billed for and the revenue that will be collected. Water undertakers must base the relevant deficit calculation on the amount of revenue that has been billed and not on the revenue that has been received. To do otherwise would penalise developers for bad debt, which is unacceptable.

3) Proportion of revenue that is allocated as income allowance.

Draft principle 6: Water undertakers must allocate 100% of the revenue from newly connected premises as the income allowance.

As mentioned above, the water undertaker's calculation of its charges to the developer for new infrastructure will take into account the revenue it expects to receive from customers connected to the new main in that year. The revenue that can be included in the calculation is defined as the proportion of charges that have been imposed by the water undertaker in relation to premises connected to the new main, that relate to providing a supply of water to those premises¹³.

When calculating the estimated or actual income allowance, water undertakers must allocate 100% of the revenue that will be received from customers connected to that main over the next 12 years.

4) Applying a discount rate

Draft principle 7: The discount rate that water undertakers use must be the cost of capital allowed for in their price limits.

The discount rate is applied to the calculation of both the commuted sum and asset payment to reflect the present value of money over time.

The discount rate that water undertakers must use when calculating requisition charges and the asset payment must be the real cost of capital allowed for in their price limits, gross of the tax shield¹⁴.

Setting the discount rate at the level of the cost of capital will produce a figure that is consistent with the revenue that water undertakers are able to recover from customers. The figure is forward looking, as it is set during the price review for the next five years.

When this figure is used, the water undertakers will also need to make an assumption about inflation.

¹³ Section 43(7) of the amended WIA91.

¹⁴ Pre-tax costs of debt and post-tax cost of equity.

5) Applying the rate of inflation

Draft principle 8: Water undertakers must forecast the long-term effects of inflation on anticipated revenue when calculating the commuted sum charge or the asset payment.

Each year water undertakers are allowed to increase their charges by RPI + K. RPI is the rate of inflation and K is the price limit that we set for each water undertaker for each year of a five-year period. The relevant deficit is calculated on the basis of the actual revenue due from newly connected properties which will include the effect of RPI and K.

Commuted sums and asset payments are based on estimates of the revenue over the next 12 years. These estimates will be more accurate if they take inflation into account for each of the notional 12 years of the calculation.

Water undertakers will know K for up to the next five years, and this amount will be included in their forecast average charges. In addition, water undertakers must also refer to long-term rates of inflation when they calculate the revenue that they expect to receive.

Water undertakers must use the forecasts, which are compiled by the economic assessment team at the Treasury to provide a figure for long-term inflation. The relevant publication is called 'Forecasts for the UK economy: a comparison of independent forecasts'.

6) Estimating the rate of connection

Draft principle 9: Water undertakers must rely on a combination of their own data and methodologies and the developer's submissions about build rate to estimate the rate of connection of properties.

Connected properties generate revenue for water undertakers. The build rate is an indication of the rate of connection of properties. Commuted sums and asset payments are usually calculated before the development has been finished. When this happens, the rate of connection must be estimated. If it is estimated inaccurately, it may skew the calculation of the commuted sum or the asset payment, which may disadvantage either the water undertaker or the SLO.

Water undertakers already apply different rates of connection. These may be based on their own information about the rates of connection or on local or historical factors. When estimating the build rate, the water undertakers must take into account all the circumstances of the work that is carried out.

7) Worked example

A worked example of how to calculate the relevant deficit, commuted sum and asset payment, taking into account all the factors listed above has been included at annex 2.

6 Non-contestable costs

Draft principle 10: Water undertakers must complete a costs breakdown template for each job, including all the costs of non-contestable elements of self-lay work and the quotations for commuted sums and asset payments.

When a developer has confirmed that the development will take place and asks for a quotation for the requisitioning charges, the water undertaker must complete the cost breakdown template at annex 3. This includes the details of its requisitioning charges and the payments that it will make for self-lay works, as well as clear and transparent costings for the water undertaker's non-contestable charges; that is the charges for the work that the water undertaker will insist on carrying out. A list of contestable and non-contestable works is included at annex 4.

The cost breakdown template has been developed by our SLG. We welcome views on its content and structure.

7 Security

7.1 Security payments

Draft principle 11: Water undertakers must not insist that security be provided in one particular form but must offer a choice of payment methods to the developer.

Under the WIA91, water undertakers are entitled to ask for security before installing new mains in response to a requisition, and we have powers to consider disputes about the security that a water undertaker requires¹⁵.

Water undertakers usually ask for security for requisition or self-lay works to be paid as cash, but bonds or insurance policies can provide the same level of cover. When requiring security, water undertakers must be flexible and allow developers the choice of paying by cash deposit or by a bond or insurance policy.

However, there may be additional overhead costs associated with administering bond arrangements or insurance policies. Water undertakers must explain clearly what extra costs will be incurred by the developer when offering them the choice of payment options.

7.2 Security payments for water requisitions

¹⁵ See section 42(6) of the WIA91.

Draft principle 12: When works are requisitioned and the water undertakers require an undertaking, the water undertaker must ask for no more than 100% of the estimated commuted sum. This must be returned when the relevant deficit becomes zero, and will remain zero, or when the final commuted sum is paid.

When work is requisitioned, there is a risk to the water undertaker that the requisitioner may go out of business before it has paid either the commuted sum or the relevant deficit charge for the work. Most water undertakers, therefore, require a deposit before starting to carry out requisitioned works. Generally this is 100% of the estimated costs of the work. However, in most cases, water undertakers will not recover the full costs of the work from the requisitioner because they will make an income allowance. Water undertakers must make the same allowance when calculating the security that they require for work.

When requisitioners choose to pay the relevant deficit charge, this becomes zero when the income allowance for that year is greater than the annual borrowing costs of the loan to finance the work. At this point, there may be no further risk to the water undertaker of under recovery of the relevant deficit, since it has already reached zero. Most water undertakers return the security to the requisitioner at this point but some prefer to retain the full amount until the end of the twelfth year, which we consider to be unreasonable.

Committed sum charges are paid once the mains have been installed. Once this payment has been made, the water undertaker must return any security undertakings.

7.3 Security payments for self-lay works

Draft principle 13: When works are self-laid, and the water undertakers require security, this must cover the costs of the non-contestable work that the water undertakers will carry out and the potential cost of remedying defects in the SLO's work. It must be held until the SLO has paid the charges for this work and the water undertaker has taken over responsibility for the work.

We said in our self-lay guidance that the level of security must be reasonable and that the security must be held for a specified level of time. Water undertakers must pay interest on any security that they hold, for the length of time that they hold it, in accordance with the rates that we issue – see section 11.

When new pipes are self-laid, there is a risk that water undertakers will not be paid for non-contestable works that they have carried out. When works are self-laid, the burden on water undertakers is relatively low and water undertaker should reflect this by asking for security that reasonably reflects the actual costs that they risk incurring. Water undertakers must not ask for security that is more than the likely costs of the work that they will actually

carry out and the costs to them of remedying defects in the work that the SLO has carried out.

8 Charges for new water supplies for non-domestic purposes

Draft principle 14: Water undertakers must consider developers' requests to self-lay non-domestic supplies. Water undertakers do not need to make an asset payment for self-laid mains for non-domestic purposes.

The provisions of the amended WIA91 that will relate to agreements to adopt self-laid water mains and service pipes will not explicitly apply where the water mains or service pipes are to be used (in whole or in part) for supplying water that is not for domestic purposes¹⁶. However, the amended WIA91 will also provide that a water undertaker is not prevented from agreeing to take responsibility for a main that has been installed, in whole or in part, for non-domestic purposes¹⁷.

This means that, if they agree, undertakers will be able to allow developers the choice of using their own contractors to lay mains to supply water for non-domestic purposes or for both domestic and non-domestic purposes. The water undertaker will be able to agree to take responsibility for the pipes once the work is completed. The pipe will be vested in the water undertaker in the same way as under an agreement to adopt self-laid pipes that are supplying water for domestic purposes¹⁸.

The Director General of Water Services (the Director) has powers in the absence of agreement between a water undertaker and a person requesting a supply of water for non-domestic purposes to determine the terms and conditions on which such a supply should be provided¹⁹. In making such determinations, the Director may therefore be asked to consider the terms on which any self-lay infrastructure should be adopted by a water undertaker.

When a developer asks a water undertaker to provide a supply of water for non-domestic purposes, the water undertaker would normally be expected to recover its expenses and, where appropriate, a reasonable return on its capital. Unlike the requisitioning of mains for domestic purposes, the water undertaker does not have to make an allowance for the future revenue that will be received from customers connected to that main.

As the legislation is does not specifically apply to non-domestic supplies, we are still developing policy on self-laying supplies for non-domestic purposes. One of the issues we are considering is whether a water undertaker should

¹⁶ Section 51A(2) of the amended WIA91.

¹⁷ Section 51A(2)(a) of the amended WIA91.

¹⁸ Section 51A(2)(b) of the amended WIA91.

¹⁹ Section 56 of the WIA91.

make a payment for asset for non-domestic supplies. We welcome your views on this matter.

9 Provisions for charging for sewers

9.1 Calculating the charges for sewer requisitions

1) Framework of charging for sewer requisitions

Sewerage undertakers will install new sewers in response to requisitions by the owner or occupier of premises and local authorities in that locality. The amended WIA91 also introduces provisions for lateral drains to be constructed as part of a requisition, and the following takes this into account. As with water mains, the sewerage undertakers are entitled to recover the costs of financing the installation of the new sewers by charging the requisitioner the relevant deficit. This is defined as the amount (if any) by which the annual borrowing costs of a loan for the costs of providing the new sewer exceeds the revenue from that sewer for that year²⁰.

The revenue that can be taken into account when calculating a relevant deficit charge for sewers, is as much of the sewerage undertaker's charges that year as are reasonably attributable to the use of that sewer to drain domestic sewage, or dispose of domestic effluent from the premises connected to that sewer²¹. As with the calculation of charges for water requisitions, the annual revenue figure used to calculate charges for sewer requisitions is referred to as the income allowance.

The relevant deficit and commuted sum charges for sewers are calculated in broadly the same way as the charges for water requisitions. The principles that apply to the calculation of charges for sewer installations are on the next page.

²⁰Section 100(1) of the amended WIA91.

²¹Section 100(7) of the amended WIA91.

Relevant deficit, for any one year	=	Annual borrowing cost of financing a new sewer, comprising the interest payments on the loan and the repayments of the capital costs of construction. Minus Income allowance, the percentage of sewerage charges from newly connected premises, which are attributable to the costs of draining domestic sewage for disposing of effluent from those premises.
Where the revenue is equal to or greater than the annual borrowing costs the relevant deficit is zero.		

Commuted sum	=	Estimated relevant deficits X Discount rate (to discount to net present value) for 12 years
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2) Changes made by the Water Act 2003

The amended WIA91 will formalise the calculation of the commuted sum. The amended WIA91 will state that the commuted sum will be the amount equal to the total of the estimated relevant deficits, discounted to the net present value, for each of the 12 years following the provision of the sewer.²²

3) Calculating the real and estimated charges for sewer requisitions

Draft principle 15: Sewerage undertakers' estimates of relevant deficit and commuted sum charges for sewer requisitions must be based on robust information and calculated consistently. Developers should provide timely and accurate information to enable sewerage undertakers to provide these estimates. Estimates of revenue must be based on the average sewerage charge per property, taking account of the different property sizes where appropriate.

Draft principle 16: Principles 5 – 9 in section 5, relating to the calculation of charges for requisitioning water mains, must be applied to the calculation of sewer requisitions charges.

Charges for sewer requisitions must be calculated according to the same methodology and principles as charges for water requisitions.

There are some variations in the definitions of the components of the charges for sewer requisitions and these are explained below.

a) The costs of installing new sewers

When developers requisition new sewers, the sewerage undertakers can charge them the costs of installing new sewers. This amount includes the costs of installing pipes as well as the costs for work involved in providing other public sewers and pumping stations that are necessary to provide the new sewer, which is known as network reinforcement²³. The costs can also

²² Section 100A(1) of the amended WIA91.

²³ Section 100(4)(a) of the WIA91.

include a proportion of the costs incurred in providing capacity in an earlier sewer, where this is used as a result of providing the new sewer²⁴.

b) The drainage charges

Drainage charges are the charges which are paid for services provided in a year to premises connected to that sewer, which are reasonably attributable to draining and treating sewage, excluding trade effluent.

9.2 Charges for self-laid sewers

Draft principle 17: When calculating the charges for self-laid sewers, sewerage undertakers should not pay developers an asset payment.

We believe there is already effective competition in the market for self-laying sewers. Developers are able to lay sewers themselves under section 104 of the WIA91, in accordance with the standards set out in the guide 'Sewers for adoption'. In addition, there is an incentive for developers to carry out this work. If a developer requisitions a sewer, the sewerage undertaker can make a charge for network reinforcement. However, when a developer lays the sewer, there is no provision for the sewerage undertaker to recover this cost.

Where sewers are requisitioned, the sewerage undertaker will calculate the income allowance on the basis of the costs of installing the sewer and any associated network reinforcement. However, if the sewers are self-laid, the developer will not incur the same level of costs because the costs of network reinforcement are not included. Hence it would not be possible to calculate the income allowance on a consistent basis.

9.3 Security required for sewer requisitions and works to self-lay sewers

Draft principle 18: When sewers are requisitioned and the sewerage undertaker requires security, the sewerage undertaker must ask for no more than 100% of the estimated commuted sum.

Under the WIA91, sewerage undertakers are entitled to ask for security before installing new sewers in response to a requisition. We have powers to consider disputes about the security that a sewerage undertaker requires²⁵.

When work is requisitioned, there is a risk to the sewerage undertakers that the requisitioner may go out of business before they have paid either the commuted sum or the relevant deficit charge for the work. We consider that the level of risk for sewerage undertakers responding to a sewer requisition is the same as the level of risk from responding to a water requisition.

When developers opt to self-lay sewers, they must have regard to the guide 'Sewers for adoption'. This sets the level of deposit for self-lay works at 10%

²⁴ Section 100(4)(b) of the WIA91.

²⁵ Section 99 of the WIA91.

for the installation of sewers. We are not proposing any revisions to this approach.

10 Infrastructure charges and network reinforcement costs for water main and sewer installations

Draft principle 19: 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.

The WIA91²⁶ entitles a water or sewerage undertaker 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 the infrastructure charge. In our view, infrastructure charges contribute to the costs of enhancing the local network of mains and sewers. However, some developers have raised concerns that water and sewerage undertakers have been recovering the costs of carrying out work twice, through infrastructure charges as well as charges for network reinforcement.

The WIA91 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 main²⁷. The WIA91 also provides that sewerage requisitioning charges can, for example, include any costs reasonably incurred in providing other public sewers and any pumping stations that are needed because of the provision of the new sewer²⁸. Such additional infrastructure, (network reinforcement) may, for example, be needed because providing the new main results in an increase in demand or because providing the new sewer results in more effluent being discharged into the sewerage network. Requisitioning charges are explained in section 4.1 and 5.3. Under the amended WIA91, we will have powers to consider disputes about the reasonable level of costs that water and sewerage undertakers can recover through charges for requisitions, including the costs of any network reinforcement.

Water and sewerage undertakers should only seek to recover network reinforcement costs from developers where the work is carried out within a reasonable period, not normally exceeding two years, of the installation of the requisitioned or self-laid main. When considering the reasonable level of network reinforcement costs, we will take into account the infrastructure charges that have been, or will be, paid in relation to the relevant premises on that site, to ensure that developers or other requisitioners are not paying twice for all or part of the same work. However, infrastructure charges should only be offset against the costs of network reinforcement that relate to the site for which the infrastructure charges were raised.

11 Interest rates for requisitioning - borrowing and deposits

²⁶ Section 146 of the WIA91.

²⁷ Section 43(4)(a) of the WIA91.

²⁸ Section 100 (4)(a) of the WIA91.

Requisition (or relevant deficit) charges under the WIA91 are calculated over a 12-year period. Under section 42(4) of the WIA91, the Director determines the rates of interest that water and sewerage undertakers pay to developers on their deposits/security for the water and sewerage undertakers work to install water mains (or interest on deposits). The Director also determines the rates that water and sewerage undertakers have to use in calculating the cost of a loan that would be necessary to fund the costs of the main laying work (or interest on borrowing).

Our policy, as set out in FD4 (9 April 1990), is to calculate these interest rates by applying an adjustment factor to the yield for a government security (gilt) of ten years' maturity. We explained in MD22 (27 February 1990) that a ten-year term is an appropriate basis for this policy, to tie as closely as possible with the 12-year length of relevant deficit agreements. Every six months, we write to water and sewerage undertakers confirming the rates, which currently use the following assumptions.

- For borrowing – 1.5 per cent for water and sewerage undertakers and 1.75 per cent for water only undertakers above the published ten-year gilt yield. This premium is to reflect the costs of borrowing to water and sewerage undertakers. The developer may benefit from the credit quality of the water or sewerage undertaker, effectively enabling it to access lower cost debt.
- For deposits – 0.75 per cent below the published ten-year gilt yield. The developer will earn a similar rate of interest to that which they would have earned if they had deposited the money in a bank. Bank rates for deposits tend to be lower than the government gilt rate. The water or sewerage undertaker can in principle earn a return above this by investing the deposit in long-term gilts. Any premium available to the water or sewerage undertaker will be offset by the risk to it of not being paid by the developer for the water main installation.

The level of the premium has been established for a long time and we feel that the industry should be given the opportunity to review and comment on this methodology.

There are three options. We can continue to use the current approach. Alternatively, it may be more appropriate to use a debt premium consistent with that used in deriving the cost of capital for price limits to calculate the interest on borrowing. Similarly, the assumptions in price limits for calculating interest rates on cash deposits could be used to calculate the interest on deposits.

Another option would be to fix the interest rates at the level assumed in price limits for the whole of the price limit period. This would ensure stability for a five-year period as the cost of capital is fixed by the period of price control. However, it would not reflect the short-term fluctuations in the interest rate within the period from the values that we have assumed. If the interest rate

was to change significantly this could benefit undertakers or it could benefit developers.

We welcome your views and opinions on these options. Please state what your preferred methodology is and why.

ANNEX 1 CURRENT MEMBERSHIP OF THE SELF-LAY GROUP

Geoff Tute – Southern Water Services

Kenny Cameron – Fusion Provida Ltd

Paul Clark – Scottish & Southern Energy plc

David Clare – Mowlem Energy Ltd

Jim Johnston – Global Utility Connections

Ray Farrow (on behalf of HBF) – TDS

Phillip Mills – Water UK

Martyn Speight – Severn Trent Water

Anthony Crawford – Thames Water

Peter White – Drinking Water Inspectorate

David Brend - WERM Ltd

Steve Calderbank – Subterra

ANNEX 2 WORKED EXAMPLE

Calculation of the relevant deficit, commuted lump sum and asset payment for water installations

Variables – Please note, these figures are examples only

Total scheme cost	£98,000
Number of properties	114
Average income per property	£96.00
Borrowing interest rate	6.75%
Discount rate	4.50%
Long-term annual inflation	3%

Definitions

Revenue now = cumulative occupancy multiplied by the revenue per property.

Projected future revenue = last year's revenue increased by rate of inflation each year.

Annual borrowing costs of the loan = one twelfth of the overall capital payable multiplied by annuity factor, based on interest rate for borrowing.

(Projected) relevant deficit = annual borrowing costs of the loan minus the projected revenue. When projected revenue equals annual borrowing costs, the relevant deficit becomes nil.

Income allowance = lesser of the annual borrowing costs or the projected revenue.

Commuted sum = equals the relevant deficit multiplied by discount rate, ie the current value of the relevant deficit payments.

Payment for asset = income allowance multiplied by discount rate, ie the current value of the income allowance.

Year	Cumulative occupancy of properties	Revenue now	Projected future revenue	Annual re-payments of the loan	A			Discount factor	B		C	
					(Projected) relevant deficit	Income allowance	Commuted sum		Asset payment			
One	23	£ 2,208.00	£ 2,208.00	£ 12,174.52	£ 9,966.52	£ 2,208.00	0.95694	£ 9,537.34	£ 2,112.92			
Two	46	£ 4,416.00	£ 4,548.48	£ 12,174.52	£ 7,626.04	£ 4,548.48	0.91573	£ 6,983.39	£ 4,165.18			
Three	86	£ 8,256.00	£ 8,758.79	£ 12,174.52	£ 3,415.73	£ 8,758.79	0.87630	£ 2,993.19	£ 7,675.30			
Four	114	£ 10,944.00	£ 11,958.80	£ 12,174.52	£ 215.71	£ 11,958.80	0.83856	£ 180.89	£ 10,028.19			
Five	114	£ 10,944.00	£ 12,317.57	£ 12,174.52	£ -	£ 12,174.52	0.80245	£ -	£ 9,769.46			
Six	114	£ 10,944.00	£ 12,687.10	£ 12,174.52	£ -	£ 12,174.52	0.76790	£ -	£ 9,348.76			
Seven	114	£ 10,944.00	£ 13,067.71	£ 12,174.52	£ -	£ 12,174.52	0.73483	£ -	£ 8,946.18			
Eight	114	£ 10,944.00	£ 13,459.74	£ 12,174.52	£ -	£ 12,174.52	0.70319	£ -	£ 8,560.94			
Nine	114	£ 10,944.00	£ 13,863.53	£ 12,174.52	£ -	£ 12,174.52	0.67290	£ -	£ 8,192.29			
Ten	114	£ 10,944.00	£ 14,279.44	£ 12,174.52	£ -	£ 12,174.52	0.64393	£ -	£ 7,839.51			
Eleven	114	£ 10,944.00	£ 14,707.82	£ 12,174.52	£ -	£ 12,174.52	0.61620	£ -	£ 7,501.92			
Twelve	114	£ 10,944.00	£ 15,149.06	£ 12,174.52	£ -	£ 12,174.52	0.58966	£ -	£ 7,178.87			
Totals		£ 113,270.00	£ 137,006.03	£ 146,094.22	£ 21,224.00	£ 124,870.22		£ 19,694.81	£ 91,319.52			

From the above example:

- the estimated relevant deficit payments are set out in column A,
 - the estimated commuted sum payment is the total of column B; and
- the estimated asset payment is the total of column C

ANNEX 3 TEMPLATE OF NON-CONTESTABLE COSTS

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

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

Site:.....

Date:.....

Item No	Description of tasks	Details	Costs
	Onsite works		
1	Approval of designs of on-site works produced by the developer/SLO		
2	Diversions*		
3	Wayleaves or easements		
4	Inspection and supervision of contestable work		
5	Water sampling and quality analysis		
6	Supplying and installing water meter		
	Off-site works		
7	Design of off site-works		
8	Off-site diversions		

*Our guidance on '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
1	Charge for network reinforcement	
2	Estimated relevant deficit charge	
3	Estimated commuted sum charge	
4	Estimated payment for asset	

ANNEX 4 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 undertakers' specifications.
- Installing service pipes to water undertakers' specifications.
- Connecting service pipes to new mains (after the water undertaker 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.
- Installing water meters.
- Determining the timing of service pipe connections to new mains.
- Connections that involve risks to existing customers.
- Connecting new mains to existing mains.
- Connecting service pipes directly to existing mains.
- Water sampling and quality testing.

APPENDIX 1 GLOSSARY OF TERMS

Annual borrowing cost

The total amount of interest and repayments of capital which have to be paid in any year.

Asset payment

The payment made to developers who self-lay water supplies for domestic purposes in recognition of the future revenue that will be received from the newly installed main.

Commutated sum

A single payment that is made by a developer to a water company for laying new water mains. This is paid as an alternative to relevant deficit payments (see next page). This is sometimes also referred to as a lump-sum contribution or fixed lump sum.

Contestable

Open to competition.

Developers

Those who organise the purchase of land, construction of new buildings and their sale.

Disinfection

Water is treated with, for example, small amounts of chlorine to ensure that it complies with water quality regulations.

Domestic purposes

In relation to water supplies, domestic purposes includes the use of water for drinking, washing, cooking, central heating and sanitary purposes. The term is defined more fully in section 218 of the WIA91

Easement

Legal right of way over another person's property, which may cover the laying of pipes.

Lateral drains

The part of a drain that runs from the curtilage of a building or premises to the sewer.

Non-contestable

Not open to competition.

Non-domestic purposes

Water supplies that are for purposes other than those defined as domestic purposes in the WIA91. This includes for example the use of water by a laundry or any business preparing food or drink for consumption off the premises.

Off-site

In the public highway or in land owned by people other than developers.

On-site

Land owned by developers.

Reinstatement

Work carried out to restore the surface of the ground to its original condition. For example, resurfacing a road after work to lay water mains.

Relevant deficit payments

Where developers requisition new mains for domestic purposes under sections 41 to 44 of the Water Industry Act 1991, they may pay for these over 12 years (the relevant deficit payments). The payments are calculated under section 43 of the WIA91.

Requisition

Water companies must provide water mains that are sufficient for domestic purposes when required to do so by a notice under sections 41 to 44 of the Water Industry Act 1991. This is known as a requisition. Water companies must provide the mains once the financial conditions of compliance are satisfied and the company has agreed the places for connecting the new pipes to its existing main/network.

Self-lay

Where developers or their contractors install new water mains and service pipes instead of asking the water company to do the work.

Self-lay organisations (SLOs)

These include developers who can lay their own mains and service pipes, contractors laying mains for the developers, and multi-utility infrastructure providers.

Service pipes

A pipe supplying water from a water main to any premises (whether in the highway or in private land).

Swabbing

A process to clear mains of dirt and materials before they are filled with water.

APPENDIX 2 DRAFT REGULATORY IMPACT ASSESSMENT

We are issuing two consultation papers on 'Financial arrangements for self-lay and requisitioning agreements' and 'Handling disputes and appeals'. This RIA applies to both of these consultations together. It is an assessment of the approach we are proposing to implement the provisions in the Water Act 2003 (WA03). We welcome your views on the points set out below. The final regulatory impact assessment will form part of the guidance documents when these are issued in spring 2004.

Defra published 'The Water Bill – Regulatory Impact Assessment, Environmental and Equal Treatment Appraisals' in February 2003. That paper identified how the new provisions in the Water Industry Act (1991) (WIA91) as amended by the WA03 will affect the industry. It stated that the new provisions will affect an average of 175,000 new connections to the water and sewerage distribution system each year and estimated that the value of the relevant market is around £100 million - £160 million each year.

We want to ensure that the new regime is implemented effectively and transparently without placing unnecessary burdens on developers and undertakers. The following is an assessment of how the principles set out in our consultation papers are likely to benefit the industry.

1. Purpose and effect of the consultation

The consultation papers seek views on the operation of the new regime for paying for new water mains and sewers and the proposed process for determining disputes and appeals. They aim to create a framework, which will do the following.

- Outline the methodologies for calculating the charges and payments for new water mains and sewers.
- Ask water undertakers to complete the cost breakdown template provided by our self-lay group.
- Not impose undue burdens on undertakers or developers in resolving disputes and appeals.

The consultation papers also propose alternatives to our current method of calculating the rates of interest on borrowing and deposits, which affects the payments that are made for new water mains and sewers.

2. Options and rationale

In setting out the framework for financial arrangements and handling disputes and appeals, we have identified three options.

1. Do nothing. There is no statutory requirement for us to produce guidance on these issues.
2. Propose a set of principles for the industry 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 that they should make.

Please let us know if you think that there are other options.

Option 1 would leave water and sewerage undertakers to set up their own arrangements and procedures. If water and sewerage undertakers are unclear about the implications of the provisions, they may miscalculate payments or implement a variety of policies, which would create inconsistencies across the industry. This may generate a high number of complaints from developers and other parties requiring new water mains or sewers. This may have a detrimental effect on competition in the market for installing new infrastructure.

Option 2 will create clarity while enabling undertakers to reach their own decisions about the best way to implement the new legislation. This will enable water undertakers to plan effectively for implementing the proposals in the WA03, including developing their internal policies and procedures where necessary. There will also be greater clarity for developers about the financial arrangements of their agreements with water undertakers. We will then take account of how the undertakers have followed these principles when determining disputes referred under the new regime. This is our preferred option.

Option 3 leaves no flexibility for undertakers to decide their own policies. We could also incur greater costs in deciding the levels of the charges and payments and monitoring and auditing undertakers' policies. This may have a detrimental effect on our ability to handle disputes that are referred to us. This option is not preferred.

In reviewing our method of calculating the interest rates we have identified two options.

1. Leave the current system unchanged, without review.
2. Review the methodology that we are using and take the views of the industry into account when deciding our new policy.

The outcome of the consultation may be that the current method of calculating interest rates is still appropriate. However, the consultation will enable us to establish our reasoning for this and improve the transparency of the regulatory process. Option 1 leaves the reasoning for our policy unclear and we prefer option 2.

3. Benefits

This section outlines the benefits of the approach we have taken in developing the principles and approach as set out in the consultation paper.

Benefits to undertakers

- It enables undertakers to plan policies to implement the WA03 more effectively and to decide a business strategy in relation to the self-lay market.
- It reduces uncertainties for undertakers, by explaining when we will intervene in disputes/appeals and the information we expect from the parties to the disputes/appeals.
- It will enable undertakers to reduce some costs in the long-term as they will be aware of the principles that they should follow when deciding policies, and what information we will require when we investigate disputes/appeals.

Benefits for developers and other customers

- It gives developers greater choice in the installation of new infrastructure and the ability to influence the timetable for water and sewerage undertakers carrying out works.
- It will require undertakers to improve the efficiency of their procedures particularly with regard to estimating costs issuing quotations and responding to disputes/appeals.
- 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 a fully informed choice about the options available to them. This option 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/appeal enables us to handle cases more efficiently and should reduce the number of complaints that we receive in the longer term.
- Our approach improves the transparency of regulation.

4. Expected costs

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

4.1 Compliance cost to the industry

- There will be the ongoing costs incurred by the water undertakers in implementing policies that meet the principles set out in the consultation paper. However, the undertakers may have to incur costs anyway when the provisions of the WA03 come into force to ensure that they are complying with the new legislation. The principles that we will set out in the final guidance paper will enable water and sewerage undertakers to focus on any changes that 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 but any costs are likely to be outweighed by the benefits that are likely to arise from a transparent regime, including competitive charges and improved efficiency.
- There may be a charge to undertakers and/or complainants for handling disputes that are referred to Ofwat. However, 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/appeals.

4.2 Compliance cost to Ofwat

- We will incur minimal costs for preparing the consultation paper and the 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 undertakers and developers take into account early determinations and refine their policies accordingly. We have estimated that the cost to us of handling disputes referred under the new regime to be £50,000 per annum. This figure will be reviewed in the light of our experience in handling disputes/appeals. We intend to recover some or all of our costs incurred in dealing with disputes/appeals from undertakers and developers.

Questions

We welcome your views on the draft regulatory impact assessment, in particular on the following.

- 1) Do you consider our analysis of the benefits and costs of the approach we have taken in the consultation is complete? If not, please explain why.
- 2) What other benefits or costs do you feel should be included? If possible, please quantify these.
- 3) Are the proposals broad enough to create a workable framework for implementing the new legislation?
- 4) Are the proposals too prescriptive to create a workable framework for implementing the new legislation?
- 5) Are there any other parties who should be included in this regulatory impact assessment?
- 6) Do you consider that the estimates of the effect on the market and the costs of implementing the proposals are correct?
- 7) Are there any other ways we could have approached this issue?