27 July 2016

Trust in water

New connections charging – consultation

www.ofwat.gov.uk

About this document

The Water Industry Act 1991 (as amended by the Water Act 2014) allows us to set rules about the charges that developers and other customers pay water and sewerage companies[1] for **new connections** and other infrastructure services.

This document is the statutory[2] consultation on:

- charging rules for new connection services;
- revised charges scheme rules; and
- proposed modifications to the conditions of the appointments of water companies and sewerage companies.

These proposed changes are intended for water and sewerage companies whose areas are **wholly or mainly in England** only.

We are seeking the views of all interested parties and welcome feedback on our proposals by **26 August 2016**.

[1] In this document, references to such companies mean companies holding appointments as water undertakers and/or sewerage undertakers under the Water Industry Act 1991.
[2] Please see the "Legal framework" section below for the relevant sections of the Water Industry Act 1991.

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Responding to this discussion paper

We welcome your responses to this document by **26 August 2016**.

You can email your response to charging@ofwat.gsi.gov.uk. You can also submit your response by post to:

Charging
Ofwat
21 Bloomsbury Street
London WC1B 3HF.

Information provided in response to this discussion paper, 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 1988 and the Environment Information Regulations 2004.

If you would like the information you have provided 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, among other things, with obligations of confidence.

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Executive Summary

Enabling a clear and customer-centric charging framework will be key to ensuring trust and confidence in the sector. We need to ensure that charges send sensible signals on which suppliers and buyers can make choices that will enable and encourage efficiency. Stakeholders have concerns with current arrangements – for example, that charges are too complex, unpredictable and unfair.

So today we are consulting formally on a new approach to connections charging for companies wholly or mainly in England. We do this using our new powers introduced by the Water Act 2014 and – as we are required to do so - having regard to recent UK charging guidance for us. Defra expect to publish more detailed guidance on new connections charges in autumn 2016.

Our new approach marks a significant change from the past and one we expect to deliver major benefits to developers and other customers. Our proposals build on and refine our March proposals in 'New connections charging – emerging thinking for discussion', which received significant support during the consultation process.

We believe these enhanced proposals will help to ensure benefits and protections to a range of stakeholders, as follows.

Developers will:

- benefit from **clearer, more predictable and stable charges** that better support their business models, for example, through being offered fixed charges which give earlier visibility of their connection costs;
- benefit from **charges tailored to their needs;**
- benefit from **fairer charges**, for example, we will require infrastructure charges' revenues to balance, as far as reasonably possible, with relevant expenditure over a rolling five-year cumulative period, ensuring developers don't pay for pre-existing issues and only pay on a pro-rata basis for assets that benefit a wider set of customers;
- benefit from more **effective competition**, for example through ensuring charges work for self-lay organisations and new appointees;
- be **protected because the balance of costs must remain broadly as it is now;**
- be **protected by transitional arrangements**, meaning our new rules will not undermine the business case for any existing developments; and
- benefit from **potentially faster connections**, because companies can set charges which are simpler and quicker to calculate (that is, without the need for

ad hoc modelling) and charging arrangements that can better accord with **anticipatory investment.**

Other customers will:

- benefit from companies being able to encourage developers to locate and design their developments in a way that lowers companies' costs, **enabling bills to fall** particularly in the long term;
- benefit from companies being able to incentivise lower water consumption – reducing their costs, also benefiting the **environment** and improving **resilience**; and
- be **protected because the balance of costs must remain broadly as now**.

New appointees and self-lay organisations will be protected from being disadvantaged or discriminated against.

We intend to use a wide range of regulatory tools. This not only means formal enforcement action for rule breaches, but also includes:

- asking companies to report their compliance in an **annual assurance report**, signed off by their board of directors, that they have implemented our rules;
- using our **company monitoring framework** to promote adequate governance and assurance;
- using improved **annual performance reporting** to monitor companies' spending and revenues
- exploring how we can use **risk-based reviews** to promote better stakeholder engagement between companies and their stakeholders.

A key part of our approach involves companies taking ownership of their relationship with their customers. Among other things, this allows companies to tailor charges to their local circumstances and customers' needs. We want innovative charging arrangements to emerge. For example, Southern Water and Eastleigh Borough Council – supported by Waterwise - are piloting a variable infrastructure charge which could benefit developers, customers and the environment.

We recognise concerns raised by some stakeholders regarding the absence of a proposed standardised structure for new connections charges. We will monitor the development of companies' charging arrangements and continue to engage with stakeholders. We can consider further standardisation or guidance in future should the circumstances warrant it.

Implementation for April 2017 means timetables could be challenging. We think the timing is possible and will allow the potential benefits of the new charging rules to be delivered as soon as practicably possible. This document contains our detailed proposals. We encourage stakeholders who have not already done so to start preparing for new charging rules now.

We welcome your responses to this document by **26 August 2016**.

1. Introduction

This consultation document sets out our proposals to implement new charging arrangements[3]. Implementing these changes requires:

- introducing new charging rules for new connections;
- changes to our charging scheme rules (since infrastructure charges – a key charge faced by developers - are governed by these rules); and
- changes to companies' licence conditions (licence condition C concerns infrastructure charges).

The document is it structured as follows.

- Chapter 2 – Background and approach.
- Chapter 3 - Overview of our March discussion document proposals.
- Chapter 4 - Improvements and clarifications to our March proposals.
- Chapter 5 - The impact of our proposals.
- Chapter 6 - Next steps.
- Appendix 1: Proposed charging rules for new connections.
- Appendix 2: Proposed changes to charging scheme rules.
- Appendix 3: Draft Modification – Condition C (Infrastructure Charges).

We are also consulting on our draft impact assessment. We have published this as a separate appendix to this document.

[3] Throughout this document, we use the term 'developer' to refer to any business or individual whose buildings or premises new require water or drainage services.

2. Background and approach

In this chapter, we discuss our approach to developing new connections rules and how it fits into a wider context. The chapter is structured to discuss the following topics:

1. our strategy
2. the legal framework
3. government guidance
4. our policy development process
5. related workstreams.

2.1. Our strategy

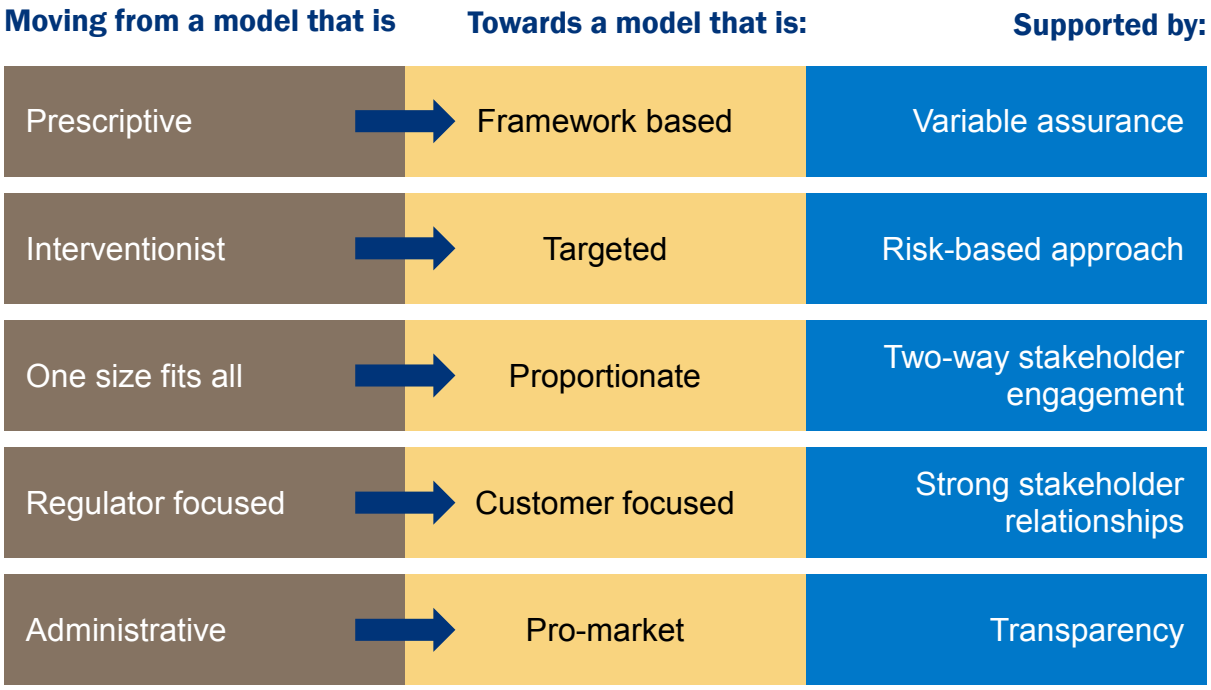
As the economic regulator, our shared vision for the water sector in England and Wales is one where customers and wider society have trust and confidence in vital public water and wastewater services. As discussed in our emerging thinking document, in March, it is clear that the current charging framework for new connections is not providing this.

Getting charging right has a number of advantages to customers and others. It can do this through a number of means.

- **Sending cost reflective signals.** For example, the cost of network expansion can be reduced through sending cost-reflective connection charges.
- **Protecting the environment.** For example, charges provide an opportunity to improve the delivery of social benefits such as environmental protection where charges reflect the value of the environment and potential impacts on it.
- **Requiring transparency and predictability.** This shapes customers' experiences and helps build trust in the provision of services, and can help manage costs.
- **Helping affordability, fairness and acceptability.** Our rules can help ensure that a company's revenue (which is set through our price controls and recovered through charges) comes from the appropriate group of customers. Change in how costs are recovered through charges can create **winners and losers.**
- **Promoting effective competition.** Clear, stable and cost-reflective tariffs can potentially facilitate efficient entry, especially when coupled with other measures.
- **Reduced administrative burden.** For example, in terms of reduced number of disputes.

Figure 1 shows our regulatory model. As described in our emerging thinking document, our view is that our rules should be proportionate and targeted, rather than being overly prescriptive. We think there is merit – particularly in the early years of the new regime – to allow scope for companies to introduce innovative charges.

Figure 1: our regulatory model



We recognise that the charging framework for new connections is complex, and rules are likely to evolve in future years reflecting on learning from how our rules are interpreted and implemented.

2.2. Legal framework

The Water Act 2014 makes changes to the Water Industry Act 1991 to allow us to set rules about charges for new connections – this is where an owner or occupier of a premises/building, to which the supply of water and/or wastewater services will be provided, requires access to the existing public water supply or wastewater system by means of a service pipe or lateral drain and/or a new water main or public sewer.

Section 144ZA of the Water Industry Act 1991 ("WIA91")[4] sets out the main legal basis of the new rule-based framework for new connection services. It allows us – in accordance with the relevant sections of the WIA91 – to set rules about the charges a relevant water company makes to developers for:

- the provision of new water mains;
- connections with water mains;
- ancillary work for connections;
- the provision of public sewers or lateral drains;
- communications with public sewers; and
- the moving of pipes.

Sections 51CD and 105ZF of the WIA91[5] set out the legal basis for us to set rules about the self-lay charges and asset payments for the adoption of water and wastewater infrastructure respectively.

Infrastructure charges[6] are included in relevant companies' statutory end-user charges schemes made under section 143 of the WIA91. Section 143B of the WIA91[7] sets out the legal basis for us to set rules about those charges schemes. Currently, the maximum value of infrastructure charges is set out in companies' licences.

Our charging rules can in particular:

- make provision about the types of charges that may be imposed;
- make provision about the amount or maximum amount, or the methods for determining the amount or maximum amount, of any type of charge;
- make provision about the principles for determining what types of charges may or may not be imposed;

[4] Section 144ZA was inserted in to the WIA91 with effect from 1 April 2016, in relation to water undertakers and sewerage undertakers whose areas are wholly or mainly in England, by section 17 of the Water Act 2014.
[5] Sections 51CD and 105ZF were inserted into the WIA91 with effect from 18 December 2015 by sections 10 and 11 of the Water Act 2014 respectively.
[6] As well as recovering any costs incurred in making connections to a water supply or a public sewer, water undertakers and sewerage undertakers can also make a charge for the connection to a water supply or a public sewer of premises which have never at any previous time been so connected for domestic purposes (see section 146(2) of the WIA91). These charges are known as "infrastructure charges".
[7] Section 143B was inserted into the WIA91 with effect from 1 November 2015 by section 16 of the Water Act 2014.

- make provision about the principles for determining the amount of any charge that may be imposed;
- provide for charges to be payable over a period; and
- make provision about publication of the charges that may be imposed.

These rules will cover the charges made to developers by companies in relation to new connections to both household and non-household premises, but only where the connections are for ordinary domestic purposes (normally drinking, washing, cooking, central heating and sanitary purposes). The rules will **not** cover:

- water undertakers and sewerage undertakers whose areas are wholly or mainly in Wales (currently Dŵr Cymru Cyfyngedig and Dee Valley Water plc);
- applications for a supply of water for non-domestic purposes (for example, for factory production purposes) or to discharge trade effluent to a public sewer;
- charges made to water supply or sewerage licensees (where they are arranging connections); or
- charges made to other water undertakers or sewerage undertakers (including new appointees) to provide a bulk supply of water or bulk discharge services.

This document is the statutory consultation on:

- charging rules for new connection services (including agreements for the adoption of self-laid infrastructure), as required by sections 51CE, 105ZG and 144ZB of the Water Industry Act 1991;
- revised charges scheme rules, as required by section 143C of the Water Industry Act 1991; and
- proposed modifications to the conditions of the appointments of water undertakers and sewerage undertakers whose areas are wholly or mainly in England under section 55 of the Water Act 2014.

Once the rules are in place, if we consider that a company is not acting as required by rules, we may give the company a direction to do, or not to do, a thing specified in the direction. Such directions will be enforceable as if they were licence conditions.

In developing our charging rules, we are required to have regard to relevant government guidance. Where appropriate, we will update our rules (subject to appropriate consultation) after they have been issued. This enables a more flexible framework than the basis of charging currently set out in primary legislation, since it allows us to monitor developments in the market and respond to them as necessary.

2.3. Government guidance

On 29 January 2016, Defra issued its 'Charging guidance to Ofwat.' This general guidance set the overarching statement of charging policy and principles and the UK Government's expectations about charges for new connections.

On 10 June 2016, Defra supplemented this guidance and published its consultation 'Water industry: draft guidance to Ofwat for water and sewerage connections charges' containing further detail on the charges for new connections that water companies may make to developers. Defra expect to publish its final guidance in autumn 2016.

As in the general guidance, Defra proposes to structure its guidance for new connection charging around four overarching principles, each with an equal weight:

- stable and predictable charges;
- transparent and customer focused charging;
- fairness and affordability (to both current and future customers); and
- environmental protection.

In August 2015, the Welsh Government consulted on general charging guidance to Ofwat. Welsh Ministers will issue the final guidance covering the companies that are wholly or mainly in Wales in due course, and are also investigating options for more detailed guidance relating specifically to new connections which they expect to issue in late summer 2016.

We expect to implement rules for the companies operating wholly or mainly in Wales at a later time than for the companies operating wholly or mainly in England (most likely for 2018-19). These rules will need to reflect the specific considerations set out in any guidance for Wales. In the meantime, the existing framework will remain for companies operating wholly or mainly in Wales.

Furthermore, there are specific standards set by Welsh Ministers for new gravity foul sewers and lateral drains. Any charging rules we set for companies operating wholly or mainly in Wales will have regard to these standards, as well as guidance issued by the Welsh Ministers.

2.4. Our policy development process

In 2013, we published our discussion paper on charging for new developments. It described a range of issues with the current charging framework, discussed content of charging rules and sought stakeholders' views.

During the early part of 2016, Defra has convened a series of Task and Finish groups with active engagement from developers, water and sewerage companies, self-lay representatives, us and others. On 8 February 2016, WaterUK also hosted an event to consider charging issues.

In March this year, we consulted on our emerging thinking for new rules. The following chapter summarises our key proposals and stakeholders' responses to them.

Since our March consultation, we have continued to engage with stakeholders through:

- co-chairing the Defra-convened New Connections Charging Task and Finish Group; and
- engaging in a series of meetings with key stakeholder groups where additional engagement was judged necessary, for example with self-lay organisations, new appointees and the Consumer Council for Water (CCWater).

Consequently, we have strengthened, refined and clarified our proposals, as described in chapter 4.

2.5. Related workstreams

Charging rules for new connections are just one element of our work to improve trust and confidence in the delivery of developer services to customers. This wider work links to and supports the implementation of the charging rules for new connections. Key steps in this journey have included:

- setting out our general expectations of how water companies provide new connections in relation to customer service; competition law compliance and planning for and enabling growth;
- water companies agreeing a set of levels of service for a range of developer services activities and reporting their performance against these each quarter;
- seeking assurances from those water companies underperforming on the levels of service agreed by the sector, as to how they will be making improvements to

their delivery and how they will communicate these and their performance to their customers;
- highlighting the importance of competition law compliance in water companies' application of charges and other non-charge requirements for developer services, following our decision to accept binding commitments under the Competition Act 1998;
- consulting on Trust and confidence: self-lay provision of new connections, to enable the sector to identify and address potential barriers to competition; and
- WaterUK establishing a National Water Self-Lay Forum bringing together representatives from water companies and self-lay organisations to develop best practice across the sector and remove potential barriers to competition.

These and other activities have seen water companies engaging with their developer services customers to better understand and respond to their needs. This customer engagement also enables water companies' understanding of where and when new development will come forward and the impact this will have on existing networks. This is key to ensure required investment in infrastructure is made at the right time and efficient for all sets of customers.

This wider work to improve customer relationships and service delivery continues and key activities for 2016-17 will include:

- WaterUK's further development of the levels of service that water companies report on, in particular to include more measures relating to the services the self-lay organisations and new appointees rely on in order to effectively compete to provide new connections;
- our engagement with stakeholders to scope out the potential content for the code(s) in respect of self-lay agreements that we will be required to issue (when the relevant provisions of the Water Act 2014 are brought into force);
- publishing guidance for the water sector on competition law;
- providing further clarity on our general expectations of how companies engage with the statutory planning system and how this relates to their obligations under the Water Industry Act 1991;
- issuing a consultation on regulatory reporting proposing changes to the regulatory accounting guidelines for 2016-17 and for 2017-18 (later this year), in order to obtain more detailed cost information on new connections and other costs associated with developer charges in companies' annual performance reports; and
- consulting in our Water2020 decision document Water 2020: our regulatory approach for water and wastewater services in England and Wales, which includes how to treat developer services in the network as developer services

revenues and seeking views on which services should fall within the generic term ‘developer services’.

In the course of our policy development process, issues were raised which are related to charging, but cannot be addressed through charging rules. For example, some stakeholders raised issues around the timing and clarity of quotes. And new appointees raised some issues that would be better dealt with through rules about the bulk supply, or bulk discharge, charges made by one water company to another. We will explore with stakeholders whether and how it might be appropriate for us and/or companies to help address these concerns in other ways.

3. Overview of our March discussion document proposals

In our emerging thinking document, we discussed the rules we could set to help facilitate water companies adopting improved charging models. This chapter gives:

1. an overview of charges currently in operation
2. an overview of the proposals we set out in our March discussion document
3. a summary of stakeholders' responses to our March proposals.

3.1. Overview of current charges

Charges for new connection services include the following charges.

Connection charges paid by the developer to the water company. They recover the costs of connecting the premise to the water main or public sewer.

Requisition charges paid by the developer to the water company. They recover the costs reasonably incurred by the water company in providing the assets to serve the new development, where costs exceed the income received from the premises served by the new development over 12 years according to the RD/DAD calculation. Requisition charges also include the cost of network reinforcement triggered by the development. Not all new connections require a requisition.

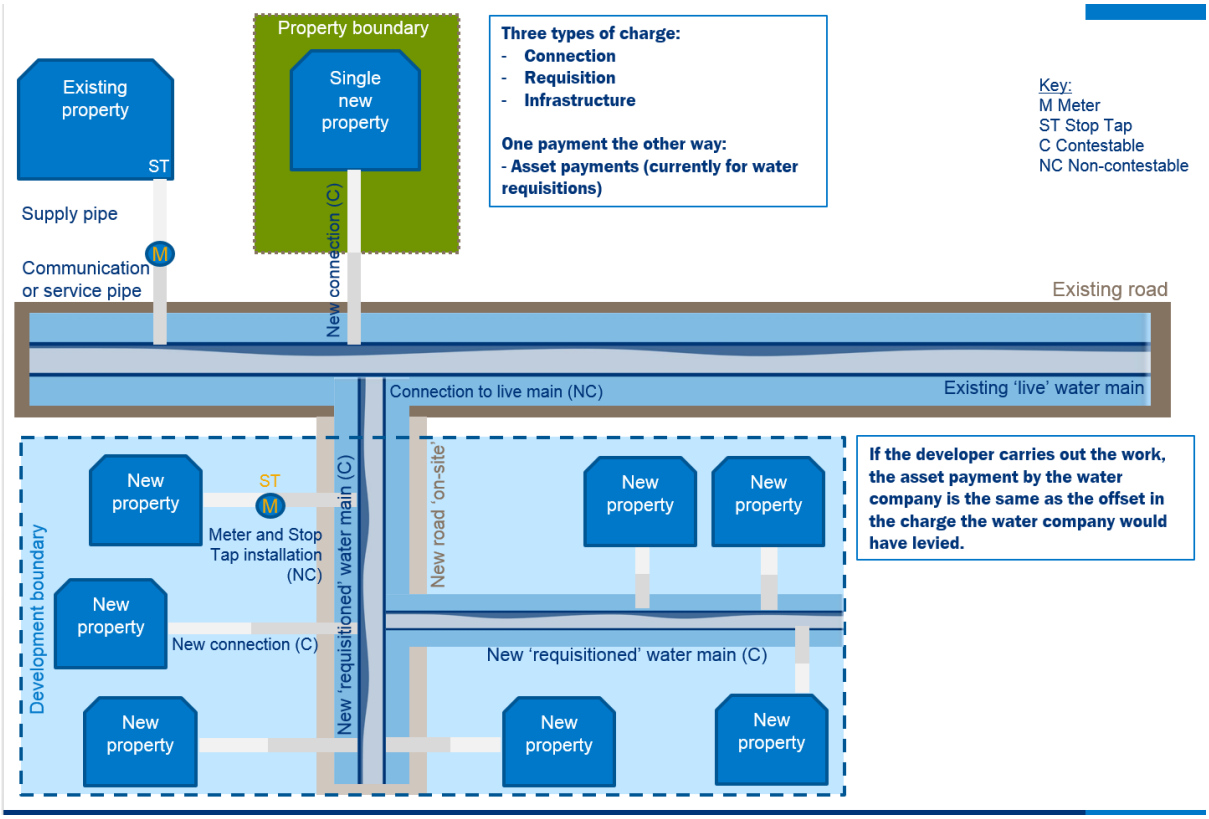
Infrastructure charges paid by the developer to the water company when a premise is connected to the company's water supply or sewers for the first time. They contribute towards wider network reinforcement. They are a capped fixed charge which is the same across the country.

Asset payments paid by the water company to developers once the water company adopts the assets. Asset payments only apply to water assets. The calculation for the asset payment is the inverse of the RD/DADs calculation.

Self-lay charges are paid by self-lay operatives (SLOs) to water companies. SLOs compete with water companies and NAVs for on-site works. The charge covers the costs the water company incurs in providing infrastructure or using additional capacity to supply a development where some of the assets are self-laid but some of the assets are required to be provided by the water company. SLO charges only apply to water supply assets.

In the diagram below, we show how new connections charges currently operate in practice.

Figure 2: Overview of new connections charges



3.2. Overview of our March proposals

Our overall view for charging in 2017-18 was to allow for some degree of flexibility and potential innovation in companies' charging structures. Our proposals aimed to:

- increase the **transparency** of companies' charging publications, the engagement between companies and stakeholders before publication and clarity over which charges are expected to recover what costs;
- increase **predictability** by requiring companies to set out upfront a number of their charges (or clear methodologies for calculating charges);
- place the **ownership of and accountability** for charging approaches with water companies. This should enable greater flexibility for more straightforward approaches and fewer arbitrary calculations. However, we said that we will set a requirement for companies, in developing their approaches, to consider the role of charging structures that send environmentally-beneficial price signals to developers and to promote overall system resilience; and

- help promote a **level playing field,** for potential alternative providers that wish to compete with water companies to provide new connections by requiring equivalent charging for equivalent services.

In chapter 5 of our emerging thinking document we discussed the rules that we could set, structured around the overarching objectives set out in Defra's guidance. Table 1 below summarises our proposals.

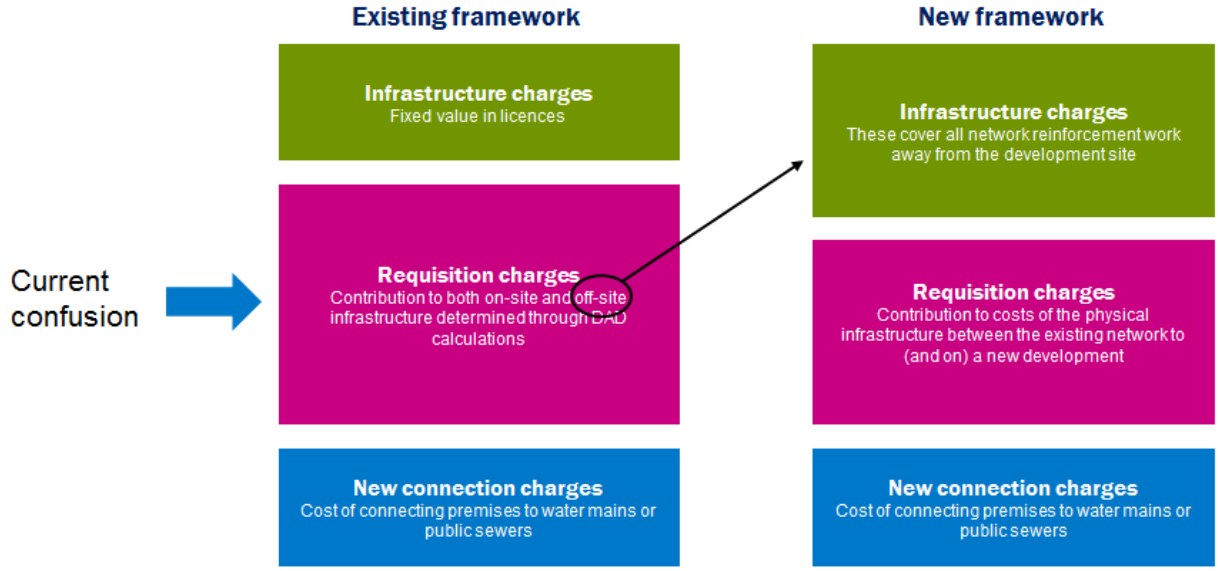
Table 1: Summary of our March proposals

Objective	Our emerging thinking
Fairness and affordability	**Not to set a rule that requires the 12-year income deficit approach**. Instead, we could **set a rule requiring water companies to publish their proposed approach of balancing costs between developers and customers**. Such proposals will need to be informed by engagement between companies and their key stakeholders. Any substantial changes from the current balance will need to be accompanied by strong objective justification so as to be seen as legitimate by stakeholders.
	Set a rule whereby developers should not be required to bear the costs of reinforcing, upgrading or otherwise changing existing network infrastructure to address pre-existing shortfalls in capacity or capability. This could help ensure a fair allocation of cost recovery between developers and bill payers.
Transparency / customer-focused	**Set a rule requiring water companies to set out their new connections charges in a single document**. The document would need to explain how companies had derived each charge and be easy to access and understand. How the water companies perform in this area could feed into the overall company monitoring framework and the targeted discussions we have with companies regarding how they improve their performance more generally. To further aid transparency, we could **set out in the rules a series of principles for what each charge is expected to recover**.
	Infrastructure charges **Set a rule that water companies can only levy a single charge for each service for work that is remote from the site**, rather than recover some of the costs through infrastructure charges and some through requisition charges (the single charge may vary depending on the nature of the development).To aid transparency, we will **set a requirement for companies to set out a clear methodology statement explaining how they have calculated this charge**. Companies may use a zonal approach or alternative methodologies. Any approach must reflect the costs of network reinforcement resulting from new developments (and not of reinforcing, upgrading or otherwise changing existing network infrastructure to address pre-existing shortfalls in capacity or capability). To enable this rule, **remove condition C (and potentially make changes to condition D) from water companies' licences** either as a consequential licence change under section 55 of the WA14 or by individual agreement with each company under section 13 of the WIA91. **Expect water companies to cross-check their new charging approaches against the current framework in terms of where costs are recovered from in order to demonstrate that the current balance of charges between customers and developers is broadly maintained.**

Objective	Our emerging thinking
	The removal of the current cap on infrastructure charges could lead to a change in the charges levied. Water companies would be financially neutral to such changes, due to the current single-till price control and therefore would not have an incentive to increase charges to developers.
	Asset payments and self-lay charges Not to set a rule requiring asset payments and self-lay charges to apply for wastewater adoption agreements for April 2017. Because the differences in approach between the current water and wastewater charging frameworks are arbitrary, we considered whether there is merit in setting a rule requiring asset payments and self-lay charges to apply for wastewater adoption agreements. However, we considered there was the potential for such a rule to come into tension with the UK Government's guidance that the current balance between contributions to costs by developers and bill payers should be broadly maintained. To date, we have not been provided with any data/analysis on the extent that asset payments and self-lay charges for wastewater would offset each other in aggregate. Set a rule requiring companies apply a consistent approach to asset payments, where they had moved away from the current 12-year income deficit calculations. Companies would need to ensure a level playing field with any SLO.
Stability and predictability	Not to limit companies' charges to only being fixed fees, e.g. for particular materials such as meters or certain activities such as site visits. Water companies would be able to offer alternative forms of charging (such as having post-delivery true-ups) where such approaches were beneficial to both customers and developers. Over the longer term, we see there could be benefits of further sector-wide standardisation in the structure of charges. Our current preference is for this to be sector led (within the parameters of their obligations under competition law). But if we do not see substantial progress in this area, we may choose to set rules to promote a harmonised charging framework across the sector. This could take the form of specifying a set of minimum requirements regarding how charges are calculated and presented.
Environmental protection	Not to set an explicit requirement for April 2017 for companies to send price signals when developing their charges (as well as promoting overall system resilience), through the use of denominators such as expected litre-per-second demand or volume of expected water returned to the sewer of the development in question. This would require appointees to engage with developers to understand the nature of their development and could encourage greater collaboration between developers and land owners to adopt sustainable solutions. This could represent a significant change, so we discussed the possibility of setting a general requirement for companies to consider charging structures that send environmentally beneficial price signals and promoting overall system resilience, when developing their charges and seek to strengthen this requirement in future years.

Figure 3 below illustrates our proposed new structure for charges.

Figure 3: Our proposed structure of charges



3.3. Summary of stakeholders' responses

In total we received 23 responses to the ten questions we asked in our informal consultation. Responses were received from 15 companies, three new appointees, two representative bodies for developers, one representative body for self-lay organisations, Water UK and CCWater. We are publishing consultation responses alongside this document.

The rest of this chapter summarises the key points coming out of consultation. We reference stakeholders' responses in more detail in chapter 4 where they relate to the proposals being put forward.

Stakeholders were generally supportive of the following proposals:

- requiring companies to **engage with stakeholders** as part of the new charging rules, as it would improve trust and confidence in the sector; some companies said continuous and proportionate engagement was necessary and self-lay organisations thought that specialist knowledge would make engagement more meaningful;
- **maintaining the balance of charges between developers and other customers** to help avoid incidence effects and protect customers;
- promoting a level playing field by **increasing transparency,** with many saying it would help companies build trust with stakeholders;

- **infrastructure charges covering remote work from the site** triggered by the development as it is an effective way of increasing transparency and also resolve the problem of perceived double charging; and
- **optional asset payments for wastewater,** as the majority of stakeholders saw difficulties in **mandating** an asset payment for wastewater in this current price control period as this could make it difficult to maintain the balance of charges between existing customers and developers, potentially increase customer bills and there was not enough evidence this would bring competition benefits.

There was some need for clarification or refinements regarding:

- the **calculation of infrastructure charges,** where there seems to be some misapprehension that infrastructure charges would still be capped and therefore significantly limit cost reflectivity.[8] Also, some companies said our rule requiring expenditure and money raised through infrastructure charges to balance over a single year was too short – making infrastructure charges too volatile;
- **transitional arrangements** – where stakeholders generally agreed that if a customer had entered into an agreement or had been given a quote under the old rules, our new rules should not apply;
- **further information** we should collect to aid transparency of charging and enable ongoing monitoring and enforcement, with some suggestions for more granular data to be collected to aid monitoring; and
- some stakeholders said that there should be **ongoing or regular assurance**.

There were also areas of more debate or concern with our proposals:

- many stakeholders were supportive of giving companies the **flexibility** to develop their own charging scheme, so they could simplify their charges and innovate, as well as concern that we avoid a 'one size fits all' approach. However, there was general agreement that this would lead to a **diversity of approach**, with some raising concerns about **complexity**;
- a few raised a concern that our proposals would **not ensure a level playing field for new appointees** if companies could use the new flexibility our proposed rules provide without considering the impact on them;
- a wide range of stakeholders were also concerned about the **tight timescales for implementation** in April 2017 – most companies did not think the current timetable allowed enough time to develop new charges schemes with adequate

[8] As discussed later, as we plan to remove the existing cap licence condition C, the infrastructure charge will no longer be capped at a fixed rate.

consultation, although an exception to this was Yorkshire Water who said they are undertaking preparatory work to help implementation; and

- **water companies consulting on new charging schemes** – overall stakeholders agreed that customer engagement between water companies and stakeholders is important. However, one company - Severn Trent Water - thought that a rule requiring companies to engage with a prescribed list of stakeholders would exclude some groups. In support of this view, other stakeholders suggested that new appointees and local authorities should also be consulted.

4. Improvements and clarifications to our March proposals

Given the support for the key features of our March proposals, we propose to retain them. This section focuses on our proposed improvements and clarifications to our March proposals, categorising them into:

1. overarching issues
2. fairness and affordability
3. transparency and customer focused
4. stable and predictable charges
5. environmental protection
6. implementation.

4.1. Overarching issues

No hierarchy of charging principles

We propose:

- to maintain parity between the four charging principles, set out in the rules, rather than prescribing a hierarchy.

Some water companies during our stakeholder engagement suggested prioritising charging principles. However, we note that the UK guidance from Defra specifically states that their charging objectives should be given equal weight. In our view, it is for companies to carefully balance these principles (along with how they meet their other obligations). In general we would not expect there to be a conflict between these principles. If significant conflicts do arise, we would expect companies to address this through consultation with their customers.

4.2. Fairness and affordability

Tailoring the level and structure of infrastructure charges to customers' needs

We propose:

- maintaining the proposed new structure of charges, as set out in our March document and figure 3, above; and
- clarifying that companies have a significant amount of discretion in setting infrastructure charges under our proposed rules – we neither require a flat infrastructure charge, nor endorse any other particular model for setting infrastructure charges (e.g. zonal).

Our proposal for redefining the infrastructure charge to cover offsite network reinforcement received wide support from a number of companies (Severn Trent Water, Thames Water, Yorkshire Water, Affinity Water, South East Water and South Staffordshire Water) as well as developers, self-lay organisations, new appointees and CCWater.

There appeared to be some confusion about the nature of the infrastructure charges we were proposing. **Zonal charging**, as noted in our March consultation, has a number of potential benefits. However, we are not endorsing any particular approach to setting an infrastructure charge. A number of other companies stated that zonal charging brought its own issues and might not be appropriate for all companies. We also note that some companies (Bristol Water, South West Water as well as Dŵr Cymru) were concerned that small developments who do not trigger network reinforcement would be paying more than the actual network reinforcement costs from their connection.

It is also worth clarifying what we are defining as off-site network reinforcement: this covers the provision of other assets that are necessary as a consequence of the provision of a new main or sewer or the making of connections to an existing main or sewer[9].

As pointed out by some respondents, our rules allow companies to set infrastructure charges in various ways, potentially ranging in their degree of cost reflectivity and

[9] So for the water service, consistent with the existing section 43(4) of the WIA91, off-site network reinforcement includes costs associated with providing other water mains, tanks, service reservoirs and pumping stations as well as providing additional capacity in an existing main. It does not extend to the costs of providing additional water resources or water treatment assets.
In the wastewater service, consistent with the existing section 100(4) of the WIA91, offsite network reinforcement includes other public sewers, pumping stations and providing additional capacity in existing sewers. It does not extend to the provision of additional sewage treatment. We discuss this further in the following section.

pricing in of wider social impacts ('externalities'). For example, companies may introduce:

- a simple, **flat charge** across a company's network;
- **locational charges,** for example, reflecting the potential availability of spare capacity in different sections of the network;
- charges to promote **environmental protection** (see box 1); and
- a more detailed methodology reflecting more site-specific **characteristics**.

For example, we consider that allowing companies to set infrastructure charges[10] that cover all off-site network reinforcement works needed to support the new development, increases predictability of charging and would therefore remove any disincentive to invest ahead of need where it is efficient to do so. This should make investing ahead of need easier which in turn, may help to reduce the scale and frequency of large cost requirements placed on developers via the planning framework.

It is therefore our view that companies should be free to determine their own approach to setting infrastructure charges which best reflects their own circumstances and the needs of their customers, within the constraints of our rules and in close consultation with their customers.

Charges for sewage treatment works

We propose:

- clarifying that there is no scope for companies to recover costs for improvements at sewage treatment works under a requisition agreement; and
- clarifying that companies should not be including such off-site costs within their infrastructure charges.

The House Builders Federation are concerned that some water companies are using the statutory planning framework as a way to make developers fund offsite

[10] To the extent that companies receive contributions from other means for off site network reinforcement work, companies should not be including these costs within their averaged infrastructure charges.

improvements at sewage treatment works due to capacity limitations in the sewer network. They submitted some evidence in support of their concern.

Water companies are often asked by a local planning authority (LPA) to review the potential impacts of a new development on existing customers, in particular to help understand and mitigate any potential flood risk.

Where there are concerns that a development would adversely impact existing customers, these companies may be able to suggest that the LPA place a condition on the developer's planning consent to address any particular concerns (or pay the water company to do this work) before planning permission is granted. The decision to do so or not remains with the LPA. The House Builders Federation claim that this process unfairly increases their costs and is detrimental to house building.

This is not an activity we can regulate under the WIA91. Any such costs are not part of the charges paid for the requisition of a public sewer under the WIA91. The existing sewer requisition provisions in the WIA91 limit the additional costs that can reasonably be recovered in relation to the provision of a new public sewer to 'such other public sewers and such pumping stations as it is necessary to provide in consequence of the provision of the new sewer' and additional capacity relating to 'earlier public sewers' (section 100(4) of the WIA91). There is therefore **no scope for companies to recover costs for improvements at sewage treatment works under a requisition agreement**. This position will not change under our proposed charging rules.

The core operation of the statutory planning system is beyond our remit. But we have a role to play in enabling a water sector that treats developers as valued customers and promoting efficient investment.

To better understand the significance of this issue, we will also be considering what specific information we might collect in relation to sewage treatment to increase the transparency of costs and revenues in this area.

Facilitating fairness though infrastructure charge credits

We propose:

- clarifying that our rules do not prevent companies from offering infrastructure charge credits for previous usage.

In accordance with licence condition C, companies currently operate schemes whereby infrastructure charge credits or allowances can be made for sites being redeveloped where there were previous connections. This must be calculated by reference to the maximum number of premises with water or, as the case may be, sewerage connections on the site in the five years before the redevelopment began. Companies can choose to offer higher credits.

Our proposals for infrastructure charges do not in any way prevent companies from continuing to offer credit schemes under circumstances such as for a redevelopment site. Our rules make clear that due account is to be taken of any previous usage and ensure that the methodology companies apply in determining such calculations must be clearly explained.

Promoting competition by helping to provide a level playing field

We propose:

- amending our rules to ensure consistent principles and approaches for non-contestable charges must be applied to the calculation of charges for different classes of customer. This includes the calculation of charges for non-contestable work, whether or not someone other than the company (such as a self-lay organisation or new appointee) is carrying out the contestable work;
- a new rule requiring companies to set their charges, income offsets and asset payments in such a way as to promote effective competition for contestable activities.

Self-lay organisations and new appointees raised concerns around potential discriminatory treatment and a lack of clarity about the application of asset payments. Both parties have a unique role, since they are both customers of companies' non-contestable activities, but are competitors for contestable activities. For the avoidance of doubt, we expect companies to apply their charges and payments that comply with our rules, competition law and other regulatory and legal requirements.

New appointees raised a concern that, where a company chooses not to make an asset payment to a new appointee and there are other compensating factors (for example a reduction in some other charge or providing for some other payment), a new appointee could be disadvantaged as compared to a self-lay organisation or the company itself. In our view, companies' system of charges, income offsets and asset payments must be set and applied in such a way as to provide a level playing field.

The application of asset payments and income offsets

We propose:

- to maintain our proposal that **asset payments for wastewater should not be made mandatory**;
- to maintain our proposal that companies have the **option of introducing an asset payment for wastewater**; and
- **keeping under review whether to require companies to offset future income against infrastructure charges from April 2020** (rather than offset against requisition charges, as now).

Asset payments are paid by water companies to developers or self-lay organisations on adoption of water assets only. Asset payments recognise that water companies will receive future income from the new connections. Currently they are calculated via a complex formula based on future income from the new connections or a hypothetical loan over a 12 year period.

In our consultation, we proposed optional asset payments for wastewater, but also asked whether to make these (and self-lay charges on sewerage assets) mandatory. We noted that mandatory wastewater asset payments might come into conflict with Defra's guidance that the distribution of costs between developers and other customers should remain in balance. We also noted there was an absence of data in this area. Stakeholders generally agreed with our assessment, saying mandatory asset payments would either come at a cost to end-user customers or require government subsidy.

During our consultation a related issue was raised with respect to income offsets. Asset payments can help to ensure a level playing field, because water companies can reduce their requisition charges (which can cover contestable activities) based on an income offset. However, there are a number of concerns stakeholders have raised regarding the application of income offsets and asset payments:

- new appointees have raised concerns that:
  a) not all companies make asset payments available to them, even though from an economic / competition perspective, there should be no obvious reason for treating them differently from self-lay operators; and

b) the proposals in our March document could inadvertently exacerbate their competition concerns, because it could allow companies to replace the current income offset with a flat percentage reduction.[11]

- Yorkshire Water also raised concerns that any uniformly applied income offset or associated asset payment may distort future competitive markets and may give rise to the risk of costly CA98 complaints; and
- self-lay organisations said that, amongst other things, more transparency is needed over asset payments as companies currently cannot always justify them when challenged.

Yorkshire Water suggested the income offset should be used in conjunction with infrastructure charges. Independent Water Networks (IWNL) propose that incumbents cannot give developers a greater discount on total costs incurred than the incumbent is prepared to offer to new appointees for the same site. Our engagement with self-lay operators indicates that they support offsetting infrastructure charges (rather than requisition charges).

In our view, we agree there are potential benefits in moving the income offset to infrastructure charges. Moving the discount to non-contestable works could remove the need for an asset payment, because everyone would receive a discount via a reduced infrastructure charge (which is paid regardless of who does the work)[12]. It could therefore bring about the following benefits:

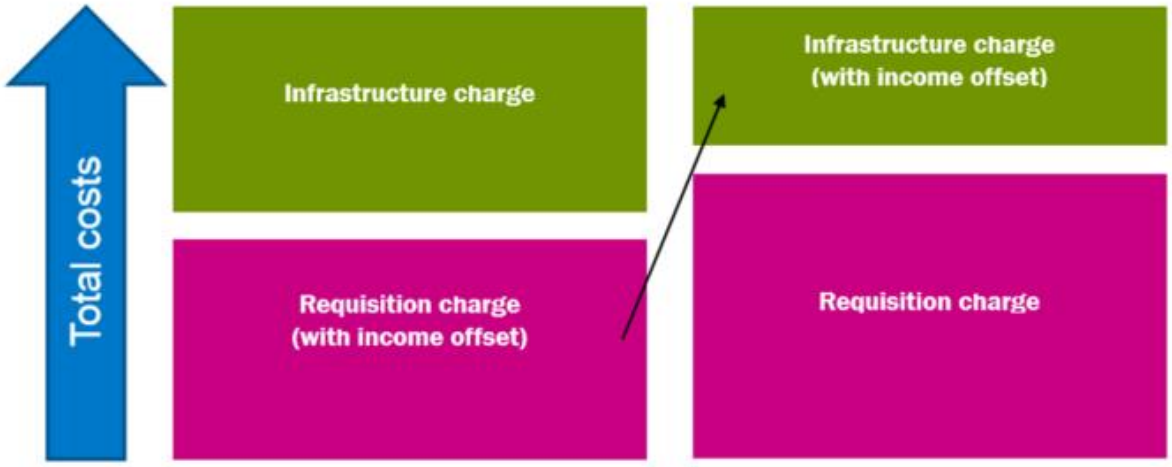
- addressing self-lay organisations' concerns around the application of asset payments and potentially reducing complexity;
- ensuring new appointees are on an equal footing to water companies and self-lay organisations (in the event that a water company doesn't pay an asset payment to the new appointees);
- helping to ensure requisition charges in future are more cost reflective (although, depending on how they are applied, making infrastructure charges less cost reflective); and

[11] The value of the income offset can vary based on a number of factors. Where the value is zero or relatively small, new appointees can compete successfully. The concern is that a percentage reduction to all requisition charges might eliminate new appointees' ability to compete for the sites where the income offset is higher than the efficient cost of providing the relevant assets. This issue could arise if they were not to receive an asset payment.
[12] This means SLOs would not be disadvantaged by the removal of the asset payment.

- potentially improve the stability of charges by reducing the increase in infrastructure charges and fall in requisition charges brought about by our new rules.

Although there are a range of potential benefits, there is also a potential interaction with both our current price control and our future price control proposals for PR19. Eliminating the need for asset payments – which are treated as a cost – improves companies' financial position by reducing their overall costs. Developers' aggregate position would be unchanged as shown in figure 4. However, because the revenue collected from developers would fall (because when they self lay, their infrastructure charge could be offset, rather than receiving an asset payment), companies could recover more revenue from other customers to compensate for this (due to our single till control). Therefore, we are concerned these changes would come at a cost to existing customers.

Figure 4: Putting the income offset in the infrastructure charge



In conclusion, we think offsetting infrastructure charges (rather than requisition charges) could be a better solution than introducing asset payments for wastewater, from our next price period control (April 2020) onwards. **We welcome stakeholders' views on this**.

4.3. Transparency and customer focused

Promoting transparency through clear definition of charges

We propose:

- a rule ensuring companies make clear what activities companies' charges are intended to cover.

During our stakeholder engagement, some customers raised concerns that it wasn't always clear what companies' charges were covering. In our view, companies should explain the services their charges are intended to cover in their charging arrangements. The objective of this is:

- to build trust that charges are fair, by ensuring customers understand the services they are being charged for and (where relevant) can tell if the service has or hasn't been provided (for example, whether a site visit has occurred); and
- for contestable activities, help facilitate competition for new connections by ensuring all parties are clear on what service is being provided for a given charge.

A prerequisite for this will be for companies to understand their own costs – a process that can potentially help companies find efficiencies.

In judging how to comply with this proposed rule (for example, the degree of granularity required) companies should consider these objectives.

We also note that Bristol Water plans to publish on their web site a plan to indicate where developments could most likely take place with little or no remote augmentation works being required. Although this is not a requirement of our rules, we think this will help customers understand where connections could be provided more easily and cheaply. We would encourage other companies to consider a similar approach.

Further encouraging customer engagement

We propose:

- clarifying that companies should determine how best to consult on changes to charges;

- to clarify that consultation should be proportionate; and
- that companies should consider how to provide transparency in how different views have been reflected in any decisions made.

In our March consultation, we proposed a rule that consultation

> "…may include (but is not limited to), as appropriate, the Consumer Council for Water, developers, local authorities, and persons carrying out contestable works (such as self-lay organisations)."

Overall, stakeholders agreed that customer engagement between water companies and stakeholders is important. Severn Trent Water thought that a rule requiring companies to engage with a prescribed list of stakeholders would exclude some groups. In support of this view, other stakeholders suggested that new appointees and local authorities should also be consulted. Although the rule was drafted to ensure the list was not exhaustive, we are concerned it might be viewed as such and that it could lead to a process-driven approach, which is not our intention. We expect companies to take ownership for their consultation process, engaging with a wide range of customers and other stakeholders. We have therefore removed this list from our proposed rule.

Some companies were concerned that the obligation to consult with customers may be disproportionate, if charging arrangements were not expected to change significantly from one year to another. We recognise that the degree of consultation required will depend on the circumstances. Therefore, we have amended our proposed rules to reflect that the degree of consultation should relate to changes in charges and be proportionate.

Some stakeholders have said to us that they want companies' consultations to be effective and want us to help ensure this happens. As discussed in the section on implementation below, we judge that effective customer engagement can be encouraged through the company monitoring framework and risk-based review process. We consider that it would good practice for there to be transparency in how different views have been reflected in any decision made. This approach would help build trust from companies' stakeholders that their views had been considered appropriately and allow them to understand the basis of companies' charging structure.

Tailoring companies' approaches to different classes of customers

We propose:

- clarifying that companies - to ensure their charges are customer focused - must consider different types of customer.

In Defra's recent 'Water industry: draft guidance to Ofwat for water and sewerage connections charges' they stated that:

> The Government is committed to doubling the number of self and custom builders by 2020. Ofwat should therefore examine how its charging rules can help to achieve this. We would expect Ofwat to consider how to make it quicker, easier and cheaper for self and custom builders to connect to the water and sewerage networks.

In our view, our charging rules will benefit all customer classes. For example, greater transparency will make it easier for developers to connect, simplified charging arrangements will help ensure these should not delay connections and pro-competitive and cost-reflective or innovative charges can help reduce the developers' costs.

In interpreting the principle of 'customer focused' charges, we expect companies to consider the different types of customer and their interests (whilst ensuring they do not unduly discriminate against any).

4.4. Stable and predictable charges

The stability of infrastructure charges

We propose:

- requiring companies to balance their costs with revenues received, as far as is reasonably possible, over a rolling 5-year cumulative period.

In our March consultation, we said that the removal of the current cap on infrastructure charges due to the inclusion of off-site network reinforcement could lead to a change in the charges levied. We explained that water companies would be financially neutral to such changes, due to the current single-till price control since the more revenue water companies recover from developers (in relation to their regulated activities), the less they are allowed to recover from water customers (and vice versa). Therefore water companies would not have an incentive to increase charges to developers.

In order to demonstrate that the current balance of charges between customers and developers is broadly maintained, we said that we would expect water companies to cross-check their new charging approaches against the current framework in terms of where costs are recovered from.

It was clear from the consultation responses that some companies had not recognised that our emerging thinking was to give them the flexibility to choose their approach to infrastructure charges. However, our emerging thinking did imply that we expected the balance of these charges to be broadly maintained in one year. This was not our intention, since we acknowledge there will be legitimate timing differences between water company costs and the infrastructure charge payments received each year.

So in order to understand and monitor the balance of costs and revenues on an annual basis, we are proposing to seek that **companies provide a commentary in their annual performance reports[13] on the balance of costs and revenue each year from 2017-18 onwards**. This will be proportionate to the scale of variance each year and will be based on a single year in 2017-18 and then cumulative total variances thereafter. Figure 5 below illustrates our proposals.

Figure 5: Proposals for reporting against variances in infrastructure charge costs and revenues

Reporting year	Cumulative variances between costs and revenues								
	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	APR review	Cumulative period
2018	X							High level	1 year only
2019	X	X							2 years
2020	X	X	X						3 years
2021	X	X	X	X					4 years
2022	X	X	X	X	X			Detailed	5 years
2023		X	X	X	X	X			Rolling 5 years thereafter
2024			X	X	X	X	X		

But, as mentioned above, we fully accept there are likely to be greater variances in the earlier years as the new charging rules are implemented and transitional arrangements are made.

[13] The annual performance reports contain water companies' financial, price control, performance and other regulatory information to demonstrate compliance with their price controls and show how the sector is delivering for its customers, environment and wider society. They use audited information that can be reconciled back to water companies' statutory accounts.

Therefore in 2022, after 5 years of reporting against the new definition (and every year thereafter), we are proposing to seek that **water companies provide a more detailed commentary in their annual performance reports on the balance of costs and income that has occurred during the period.** Again we propose this remains proportionate to the scale of cumulative variance at the end of the period. Our intention at this stage is to be fair and proportionate and only focus on those variances reported that exceed a certain threshold either in % or £m terms. **We invite consultation responses on what is a reasonable threshold to apply in the context of this new information.**

If water companies under or over recover charges against their costs, we could consider introducing an incentive mechanism at the 2019 price review (PR19). Or we could invite water companies to consider their performance in this area as part of their package of outcome delivery incentives (ODIs) in PR19.

Both would form part of our wider approach to the treatment and reconciliation of costs and revenues associated with developer services in the price control, options for which we have recently consulted on in section 7.3.5 of Water 2020: our regulatory approach for water and wastewater services in England and Wales.

Revised reporting requirements

We propose:

- clarifying that we will require a more granular level of cost information in relation to developer services in the annual performance report for 2017-18.

The current annual performance report for 2016-17 lacks sufficient information to allow for monitoring of water company costs in providing developer services.

During June 2015, we consulted on the reporting requirements for the 2016-17 annual performance report. Most respondents supported the current breakdown and analysis of capital contributions and that more transparency is preferable in this area. Disappointingly, however, few suggestions were put forward for collecting more granular cost information. Most consultation responses focused on whether a separate data collection was more appropriate than the annual performance report, the commercial sensitivity of this information and the increasing regulatory burden. Whilst we fully recognise these concerns, we are committed to ensuring stable and predictable charging in this area. In order to do that, the granularity of cost information in particular must improve. This would allow us and other stakeholders, to better understand the relationship between water company costs and the different

charges being made in line with our new charging rules. We will therefore consider these issues in more detail and propose to work collaboratively with the industry perhaps through the task and finish groups, Water UK or a separate new accounting pilot group.

Our aim is to develop a targeted and appropriate set of information requirements in relation to developer services for the 2017-18 reporting year. We consider that this will improve transparency of charging in this area and enable stakeholders to understand and monitor the balance of costs and revenues particularly for the new redefined infrastructure charging regime.

We plan to include these proposals in our consultation on the regulatory accounting guidelines (RAG) for 2017-18 which we will publish later this year.

Interactions between our wholesale charges rules and charging rules for new connections

We propose:

- clarifying that our forthcoming wholesale charges rules (as referred to in IN 16/02) would not apply to charges to developers and other end-user customers for new connections; and
- clarifying that, nevertheless, we expect companies to forewarn customers of any potentially significant changes to new connections charges.

In our March consultation, we proposed that companies publish their charges in January, before coming into effect from 1 April. We sought comments on our transitional arrangements and noted that as a consequence of our single-till approach, changes in the expected level of revenue to be recovered from developers would have an impact of the level of other charges covered by our price controls for wholesale activities. We said that, therefore, we would need to align the implementation of any charging rules for new connections with the development of water companies' wholesale charges.

Anglian Water asked for clarity regarding our transition timetable and Northumbrian Water stated that the interactions between our other charging rules needed to be considered. Yorkshire Water noted that any indicative charges for 2017 could be very indicative, unless our proposals remain largely unchanged.

We believe that there may be some confusion around the scope of our wholesale charging rules and charges scheme rules in relation to the charges covered in this document. Our wholesale charging rules will be issued under:

- section 66E of WIA91 (as substituted by paragraph 5 of Schedule 2 to the Water Act 2014) in relation to the charges made by a water undertaker to a water supply licensee; and
- section 117I of WIA91 (as inserted by Schedule 4 to the Water Act 2014) in relation to the charges made by a sewerage undertaker to a sewerage licensee.

None of the charges referred to in this document would be covered by our forthcoming wholesale charging rules.

Although we do not propose publication of indicative charges in this document, we would expect companies to manage any transition to a significantly different charging regime appropriately. This would include early engagement and forewarning of customers regarding any potential significant change.

Alignment with our charges scheme rules

We propose:

- companies' charging arrangements for new connection services be published at least two months ahead of the period in which they take effect; and
- new appointees' charging arrangements to be published no later than five weeks ahead of the period in which they take effect.

As noted in our March document, we need to ensure our charging rules for new connection services are appropriately aligned and consistent with the other rules.

In our view, companies should publish their charges for new connection services at the same time as the charges covered by our charges scheme rules, rather than charges covered by our forthcoming wholesale charging rules. Firstly, infrastructure charges fall under the charges scheme rules. Secondly, we judge that the same concerns that would motivate a different approach to wholesale charges (that is, facilitating retail competition by providing early sight to retailers and the need to feed into central systems handled by the market operator) do not apply to charges for new connection services.

That said, we have altered our requirement somewhat, so that companies' charging arrangements are published at least two months ahead of the period in which they

take effect and at least once in every year. In practice, most water companies would therefore publish their charging arrangements at the beginning of February and new appointees three weeks later, if they continue to set annual charges from 1 April in each year. However, this new wording ensures the companies have the same minimum notice period should they wish to adjust their charges during the course of the charging year.

Projections of charges

We propose:

- clarifying that where charges may not be stable, we would expect companies to publish indicative charges for future years.

During our stakeholder engagement, concerns were raised around the predictability of charges. As discussed above, we have strengthened and clarified our rules to further promote predictability. We would also expect, in accordance with the principle of predictability, that companies provide indicative projections of charges where these charges may be unstable and where such instability may be a significant concern for customers. For example, water companies should consider publishing indicative infrastructure charges for different development scenarios within their charging arrangements, where such information could be helpful.

Phasing in of significant changes

We propose:

- clarifying our expectation that companies should consider phasing in charges, if significant increases in the customers' charges are anticipated.

Some stakeholders (for example, CCWater and Fair Water Connections) raised concerns about the phasing of changes to charges.

As noted elsewhere in the document, we have amended our rules to help ensure that infrastructure charges are more stable (by allowing them to be averaged over appropriate five year periods) and proposed specific transitional arrangements to ensure existing agreements are not undermined.

More generally, we propose a principle of 'stability and predictability' (as per Defra's guidance) that companies should use when developing their charges. Therefore, in

circumstances where significant changes to customers' charges are envisaged by water companies, we would expect them to consider how to manage this. This could include, for example, through phasing in changes or transitional arrangements.

Trials

We propose:

- to clarify that the rules do not prevent companies from trialling new ways of charging.

Self-lay organisations thought that trials were an effective way of giving companies flexibility when developing new charging approaches, but there was some uncertainty about whether trials were permissible and sought clarity on this.

4.5. Environmental protection

We propose:

- maintaining our proposal to set a general requirement for companies to consider the role of charging structures that send environmentally beneficial price signals when developing their charges.

As discussed in our March consultation document, companies can send price signals to developers that can encourage efficient resource use. We are still minded to set a general requirement on companies for them to consider how their charging structures can promote environmental protection.

Box 1: Variable infrastructure charge pilot

Southern Water and Eastleigh Borough Council are testing the appetitive and practicality of implementing a market incentive mechanism of a reduced infrastructure charge to promote water efficiency for new dwellings in Hampshire.

Developers will be contacted at the planning stage and offered a 50% discount on both the water and sewage connection charges (both currently £375.60) if products are installed that sit in the green band of the European Water Label which rate the water efficiency of toilets, taps and showers.

The South Hampshire water resource zone that includes the district of Eastleigh is undergoing significant changes in terms of levels of new development, the effects of climate change and in the continuing improvement in the health of local river catchments. Water efficiency is a key priority in a wider region officially declared as in 'water stress'.

By using a specification tool, water using products identified by each developer can be easy identified and installed and the predicted water savings listed. The output of this initiative is to meet the policy requirement of the Eastleigh Local Plan which requires all large developments to achieve sustainability targets on developments. Large-scale development is due to take place with four options of between 13,800 and 20,750 new homes proposed between 2011-2029.

This initiative will benefit developers through a financial incentive, benefit customers through lower bills and benefit the Council and Southern Water through lower abstraction. A full evaluation will take place with their partner Waterwise, both before and after the pilot with all parties to fully assess its impact.

We are pleased to see that Waterwise and Southern Water have already made progress in developing an infrastructure charge pilot, as discussed in box 1. We are supportive of such approaches.

4.6. Implementation

Licence changes

We propose:

- removing the existing cap on infrastructure charges in water companies' licence condition C (Infrastructure Charges) though use of section 55 of the Water Act 2014.

In our March consultation, we asked which licensing route was most appropriate. Only Yorkshire Water responded to this point showing support for removing condition C under section 55 which would remove the cap on infrastructure charges. In our view, section 55 is an appropriate and expedient route of making the required licence changes.

Our proposed licence changes are set out in Appendix 3. This is a consultation on our proposed changes to licence condition C, as required by section 55(4) of the Water Act 2014.

Implementation date

We propose:

- maintaining our proposed implementation date for our charging rules, i.e. the next charging year starting in April 2017; and
- to review our timetable (or potentially stagger the introduction of our rules) only if our final position, published in the autumn, were to change significantly and in such a way that implementation became untenable.

It will be for Defra to replace the existing charging provisions in the WIA91 with our charging rules by bringing into force the relevant provisions of the Water Act 2014.

As mentioned in our summary of responses, stakeholders – notably companies – raised concerns that the timescale was tight. However, we note that concerns were not universal. For example, Yorkshire Water said implementation was possible. And we have not seen evidence to suggest the implementation is not possible for our proposed date.

We believe there is merit in implementing our rules as soon as practicably possible, to allow for the potential benefits to be realised as soon as possible.

We support companies thinking through at an early stage how to implement our proposals and considering preparatory work. We encourage companies to plan for how to implement our charging rules when they are published in the autumn.

Transitional arrangements: application of our new charging rules to existing agreements

We propose:

- transitional arrangements, such that our new charging rules should not apply where:
  i. a binding agreement has been entered into, or the company is under a duty to carry out the relevant works because all the relevant conditions have been satisfied, under the existing provisions of the Water Industry Act 1991 (the

structure of the existing provisions varies, but in relation to the requisitioning of water mains, for example, a water company is under a duty to provide a water main where (among other things) the conditions specified in section 42 of the Water Industry Act 1991 (including satisfactory undertakings as to payment and the provision of reasonable security) are satisfied);
or

ii. a customer and appointee agree that the existing provisions in the Water Industry Act 1991 about financial requirements for connections should be the basis on which the connection is provided, rather than the new charging rules.

- allowing these transitional arrangements to last until April 2022.

We expect transitional provisions to be included in the commencement order that Defra will make to replace the existing charging provisions in the WIA91 with our charging rules.

A number of undertakers mentioned transitional arrangements as a potential issue. For example, Bristol Water wanted clarity on how the new charging rules would affect prior agreements have been made between developers and/or self-lay organisations and water companies, particularly for larger sites which can take many years to complete. Southern Water asked for a clear implementation date and that any application processed, which is disputed, is referred back to the old charging arrangements in place at the time. South Staffordshire said that development may span a number of years and charges may be collected in advance, so for these sites the old arrangements should continue. Thames Water suggested a three-year period of grace and introducing charging arrangements for the 2020-25 price control period or allowing undertakers to waive the application of the new rules where an existing commitment has been given. IWNL suggested that quotations provided on the basis of the old arrangements should remain valid after the introduction of the new arrangements.

CCWater and Fair Water Connections also said that our rules should not create a price shock for customers.

In our view, our new charging rules should not undermine any existing agreement between companies and their customers. We therefore propose an exemption from our new rules where a company and its customer have agreed (before the new charging rules have effect) that the existing charging regime will continue to be the basis of calculations of charges for that connection. There will be a few months' gap between our publishing of the charging rules and the new charging rules having effect, so that companies and their customers will have enough notice to decide whether to use the existing charging regime or the new charging rules. This transitional period will end in April 2022 in order to allow for the complete

implementation of the Water Act 2014 reforms. Given the potentially long lead time for new developments, we think this should allow for enough time for any ongoing negotiations to be completed. However, if negotiations between a company and its customer continue past this date for a connection then from April 2022 the parties must use the new charging rules as the basis for which charges are made.

Transitional arrangements: RPI vs. CPI/H

We propose:

- maintaining RPI as the measure of inflation applied to infrastructure charges during the transitional period.

A consequence of the transitional arrangements proposed above, is that the current rules governing the infrastructure charge could extend for two years into the next price control period (i.e. from April 2020 until April 2022). In our Water 2020: our regulatory approach for water and wastewater services in England and Wales we indicated that we will move towards a new measure of inflation (CPI or CPIH) for the price control as of April 2020 (see decision document for detail). This is because RPI is statistically flawed and is increasingly falling out of use.

Given this wider context, this raises the question of which measure of inflation to use for the last two years of the transitional arrangements.

A change towards CPI or CPIH would be consistent with the fundamental argument about the decreasing legitimacy of RPI. However, RPI will be retained for an element of RCV indexation for the next price control. We are also of the view that the impact on infrastructure charges is likely to be relatively small. This is because, firstly, the period involved is very short (2 years) and, secondly, the number of customer affected is likely to be very small (because we would expect most new connections to be operating under the new, proposed regime during this period).

Therefore, we propose to maintain RPI as the measure of inflation for the full five year transitional period for infrastructure charges. This is in line with our policy intent of providing regulatory stability for developments during the transitional period, and avoids unnecessary complexity.

Company assurance

We propose:

- clarifying what should be covered by the companies' assurance statements and that we expect their board to sign these off; and
- clarifying that our rules do not prohibit companies' assurance statement covering charges other than for new connections.

Some companies asked whether the assurance required needed to be signed off by their Board of directors. Some companies asked whether a separate assurance statement in relation to the rules for new connections was required or whether this could be provided within the same document covering other charging rules. We have updated and clarified our request regarding companies' assurance. Ensuring Board-level sign off is consistent with the approach we have taken for our other charging rules. It is an approach which demonstrates that senior decision makers have engaged with the issue and that companies have taken appropriate ownership of the issue.

If companies wish to amalgamate the various Board assurances that they are required to provide to us, we have no objections to them doing so, although companies that choose to do this will need to ensure that any amalgamated Board assurance statement covers the necessary areas. We hope this approach ensures the objective of this proposal is delivered, but without being unduly onerous for companies to comply with.

Company monitoring framework

We propose:

- clarifying that charging will be a component of the company monitoring framework from the implementation date of our new charging rules; and
- clarifying our expectation that we consider good company assurance in this area to include companies' Charging Arrangements, their related consultations and any other information that they provide to stakeholders.

Stakeholders have raised concerns regarding the incentives on companies to consult in an effective manner. In our emerging thinking, we said that there would be a range of information that would be useful for companies to provide to stakeholders and that this information would be covered by the company monitoring framework.

Through our annual company monitoring framework assessment, we may consider any information that a company has provided to customers and stakeholders (or in the absence of information). We are looking for two distinct aspects of assurance. Data assurance activities that water companies have put in place to provide accurate

data and wider assurance that they provide to demonstrate that they are listening to customers and delivering services they want and can afford. Connection charging is relevant to both data assurance and wider assurance.

Under the company monitoring framework, companies' overall assurance categorisation will determine the amount of prescriptive assurance requirements that we require from them. The company monitoring framework is designed to provide a reputational incentive for companies to deliver the high standards of information that customers and other stakeholders expect. Companies in the highest 'self-assurance' category also benefit from discretion in how they carry out their assurance activities, which is less intrusive and potentially more effective and cost-efficient for them.

The detail of how charging will be assessed will be finalised once the new charging rules are implemented. To date, we have set out our final position on the company monitoring framework in June 2015 and followed this up with our re-categorisation of Bristol Water in December 2015.

It is important to note that the company monitoring framework assessment could consider companies' published charging policies and information before we finalise the code. As we stated in our company monitoring framework final position, we may consider any information that a company has provided to customers and stakeholders (or in the absence of information) to decide the appropriate category for a company under the framework.

Risk-based review

In "Water 2020: our regulatory approach for water and wastewater services in England and Wales", May 2016, we set our principles of good customer engagement as:

- using a robust, balanced and proportionate evidence base;
- engaging customers as a continual and ongoing process;
- ensuring a two-way and transparent dialogue;
- understanding the needs and requirements of different customers ;
- engaging on longer-term issues, including resilience;
- involving customers in service delivery; and
- setting the context through the use of comparative information.

In our view, charging is a key element of customers' experience of sector. Therefore, we would expect companies to follow our principles of good customer engagement when consulting on charging. Our expectation that the quality of customer

engagement should improve at PR19 will be reflected in the standards we apply to business plan quality in the risk-based review at PR19.

We have also stated that we will consider in-period performance as part of the risk-based review at PR19.

Enforcement

From ongoing stakeholder engagement and consultation responses, developers and CCWater have been particularly concerned about how the new charging rules will be enforced. Self-lay organisations also note that improvements in data on new connections is needed for us to effectively monitor and enforce the new charging rules.

Under the current regime for new connections charging, we have duties set out in the Water Industry Act of 1991 to make decisions and determinations on disputes between customers and companies relating to new connections including in relation to:

- the final charge an company can recover for providing a new connection or a new water or wastewater main;
- the level of security an company can require for providing a new water main or sewer;
- the asset payments and charges for self-laid water mains; and
- the terms offered by a company for an agreement to adopt water or sewer infrastructure constructed by somebody else.

We will retain a revised version of these duties after the relevant provisions of the Water Act of 2014 and our new connections charging rules have come into force. This will mean that customers can ask us to investigate whether a company has correctly applied its charges scheme when it bills them for a new connection or a main requisition is correct under the company's new connections charges. If we find that the company has not correctly applied its charges, we can calculate what the correct bill should be.

In addition to this, we will have powers to investigate complaints from customers who believe a company's new connections charges themselves do not follow the rules we have published. As a result, we will expect companies to retain sufficient information to demonstrate that their charges comply with our new connections charging rules. If we find that a company has issued charges that do not follow these rules, we will be able to direct them to make changes to their charges to bring them in line with our

rules. If such a direction is not complied with, it will be enforceable and could, for serious breaches, result in a financial penalty of up to 10% of a company's annual revenue.

However we will not have powers to determine disputes over the appropriate infrastructure charges for properties that are connected to the public mains and / sewers for the first time. Smaller disputes over infrastructure charges may be resolved through the water redress scheme (WATRS) although it is only able to decide on matters that have a value of £25,000 or less. Larger complaints over infrastructure charges will therefore have to be decided through the courts.

In response to our emerging thinking document, several stakeholders have raised concerns that there may be an increase in the number of disputes, once our new connections charges rules have come into effect. This is to be reasonably expected as a result of having new charges schemes that will require some interpretation, especially when they are applied to unusual cases. However, we believe that as these charges will be developed in consultation with customers and will be more open and transparent that under the current regime, this will lead to fewer disputes in the long term. The ability for companies to change their charges between charging years will also allow them to actively take steps to address issues with their charges that are leading to large numbers of disputes.

While we recognise that the industry may end up with a more diverse range of approaches to charging for new connections, where we make a determination on a dispute, we will still continue to publish the decision in order to inform other customers and allow the industry to learn from these decisions and take actions to prevent similar disputes arising in the future.

As discussed above in the section on transitional arrangements, we recognise that there will be agreements to provide new connections that have been made before our new rules come into effect, but where the new connection is not provided, or the payment for the new connection is not made until after the new rules come into effect.

It is therefore possible that, after our new rules have come into effect, a company and a customer come into dispute over a new connection that was agreed before these rules came into effect. When we consider disputes we will apply the relevant rules that apply to that work in accordance with the transitional arrangements.

5. The impact of our proposals

This section sets out an overview of the impacts of our proposals. Further details are set out in Appendix 4 where we consider more in depth the nature of the benefits and costs and the distributional impacts on different stakeholders.

Our assessment is that the benefits of our proposals outweigh the costs. This draft impact assessment is qualitative by nature and does not present an overall quantitative assessment.

Table 2: Summary of the impact of our preferred option compared to do nothing

Key benefits	Encouraging transparency and predictability: our rules would facilitate companies benchmarking their activity performance and will give developers greater certainty over future charges Unlocking competition: rules such as the socialization of 'first mover' disadvantage will balance the playing field across companies Encouraging innovation: our rules and giving companies flexibility to develop their own charging structures, may give financial incentives to make the most efficient use of water Environmental benefits: our rules encourage the use of charging structures to signal to developers unsustainable abstraction and minimize network reinforcement Long term reduction in disputes: Developers, companies as well as Ofwat will face lower regulatory burden due to less resources dealing with disputes due to fewer disagreements and higher transparency Wider economic benefits: our rules might lead to a positive impact on the whole of society such as speeding up housebuilding which may help to reduce the housing deficit
Key costs	Short term learning, monitoring costs and enforcement: Our rules might require in the short term, more resources to manage the increased variety of charges schemes Complexity and uncertainty: our rules might give rise to some ambiguity due to the higher flexibility allowed.
Risks and Uncertainties	We want companies to take ownership of their charging structures and as such companies will have a lot of freedom to develop their charges. A key risk is that companies' performance varies, meaning many of the potential benefits are not realised. Another risk is that greater non-standardisation leads to increased confusion and costs to developers in terms of understanding charges. We will mitigate these risks by a) using the full range of our toolbox to ensure companies act in the interests of consumers and b) revisiting our rules to promote standardisation, should the circumstances warrant it.
Distributional Impacts	A key element of our proposals is to safeguard the existing split of costs between developers and other customers. Therefore, we do not expect any distributional consequences to arise as a result of changes to charges.

We have produced this impact assessment in accordance with our approach to producing impact assessments. We note that the House Builders Federation and Fair Water Connections also asked us to do an impact assessment.

In carrying out the impact assessment, we have taken into account relevant policy and guidance issued by government departments, including:

- our own policy on impact assessments;
- Defra's Impact Assessment on 'Charging for water and sewerage infrastructure within new development';
- HM Treasury's 'Green Book: appraisal and evaluation in central government'; and
- BIS' 'Better Regulation Framework Manual'.

6. Next steps

We welcome feedback to our consultation by **26 August 2016**, in particular we welcome feedback to the specific questions below.

Questions

Q1 In light of our updates and clarifications, do you agree that we still retain the key features and approach of our March proposals?

Q2 Do you agree with our updates and clarifications to our proposed rules?

Q3 Do you agree that offsetting the infrastructure charge, rather than requisition charge, has merit? If so, when and how should this change be brought about?

Q4 Do you have comments on our proposed approach to implementing our rules?

Q5 Do you agree with the approach we have taken to our draft impact assessment? Can you provide quantitative figures in terms of the potential benefits or costs? Is there anything we have missed?

Q6 Do you have any comments on the drafting of our new connections rules?

Q7 Do you have comments on the draft changes to the charges scheme rules?

Q8 Do you have any comments on the drafting or our proposed licence modification, including the wording of the illustrative example.

Our intention is to both publish our rules and introduce our licence amendment in the autumn.

We will consider the charging rules for companies wholly or mainly in Wales in due course.

Appendix 1: Proposed charging rules for new connections

WATER SERVICES REGULATION AUTHORITY

WATER INDUSTRY ACT 1991, SECTIONS 51CD, 105ZF AND 144ZA

Draft Charging Rules for New Connection Services

Introduction

1. These rules are issued by the Water Services Regulation Authority under sections 51CD, 105ZF and 144ZA of the Water Industry Act 1991.

2. These rules have effect in relation to charges imposed on or after 1 April 2017 by water undertakers and sewerage undertakers whose areas are wholly or mainly in England.

3. For the avoidance of doubt, these rules do not apply to a relevant undertaker in relation to any:

    a) request for a supply of water for non-domestic purposes to which section 55 of the Water Industry Act 1991 applies;
    b) application for a consent to discharge trade effluent from any trade premises under section 119 of the Water Industry Act 1991;
    c) request made by a water supply licensee for the connection of premises to a water undertaker's supply system, or other steps in respect of that system, to which section 66A of the Water Industry Act 1991 applies;
    d) request made by a sewerage licensee for the connection of drains or sewers of premises to a sewerage undertaker's sewerage system, or other steps in respect of that system, to which section 117A of the Water Industry Act 1991 applies;
    e) charges that may be imposed by a water undertaker under an agreement to provide one or more water undertakers with a supply of water in bulk; or
    f) charges that may be imposed by a sewerage undertaker under an agreement to permit a main connection into its sewerage system by one or more sewerage undertakers.

4. The rules are supplementary to statutory provisions that apply to relevant undertakers under any enactment, or instrument made thereunder (including the

conditions of their appointments). In the event of any conflict between the rules and any statutory provision, the latter shall prevail.

Interpretation

5. Unless the context otherwise requires, in these rules:

a) "**Asset Payment**" means:
   i. in relation to a section 51A agreement with a water undertaker, the amount described in section 51CD(3) of the Water Industry Act 1991; and
   ii. in relation to a section 104 agreement with a sewerage undertaker, the amount described in section 105ZF(3) of the Water Industry Act 1991.

b) "**Charging Arrangements"** means a document setting out the charges, Income Offsets and Asset Payments, or the methodologies for calculating those, applied by the water or sewerage undertaker in accordance with these rules.

c) "**Charging Year**" means a calendar year running from 1 April in a given year to 31 March in the following year.

d) "**Communication Pipe**" means any part of a Service Pipe which a water undertaker could be, or have been, required to lay under section 46 of the Water Industry Act 1991.

e) "**Contestable Work**" means work or services that either the relevant undertaker or persons other than the relevant undertaker may do or provide.

f) "**Developer**" means any person or business which is responsible for a Development.

g) "**Development**" means premises on which there are buildings, or on which there will be buildings when proposals made by any person for the erection of any buildings are carried out, and which require connection with, and/or modification of, existing water or sewerage infrastructure.

h) "**Domestic Premises**" means any premises used wholly or partly as a dwelling or intended for such use.

i) "**Fixed Charges**" mean charges set for a given Charging Year which are fixed in amount or which are calculated by reference to a predetermined methodology set out in the undertaker's Charging Arrangements, the application of which allows calculation at the outset of the total amount owing in that Charging Year in respect of the charges in question. Such charges are to be fixed for a Charging Year, as defined above.

For the avoidance of doubt, and subject to the above, undertakers may impose Fixed Charges by reference to a unit measurement (for example, per mega-litre). Furthermore, undertakers may offer more than one Fixed Charge in charging for a service provided in accordance with the present rules (for example, by differentiating between different geographic).

j) "**Income Offset**" means a sum of money offset against the charges that would otherwise be applied for the provision of a Sewer or Water Main in recognition of revenue likely to be received by the relevant undertaker in future years for the provision of:

   i. supplies of water to premises connected to the new Water Main; or
   ii. sewerage services to premises connection to the new Sewer.

and "**Income Offsetting**" shall be construed accordingly.

k) "**Lateral Drain**" means (a) that part of a drain which runs from the curtilage of a building (or buildings or yards within the same curtilage) to the sewer with which the drain communicates or is to communicate; or (b) (if different and the context so requires) the part of a drain identified in a declaration of vesting made under section 102 of the Water Industry Act 1991 above or in an agreement made under section 104 of this Act.

l) "**Network Reinforcement"** refers to work other than Site Specific Work**,** as defined below to provide or modify such other:

   i. Water Mains and such tanks, service reservoirs and pumping stations, or
   ii. Sewers and such pumping stations

as is necessary in consequence of the Site Specific installation or connection of Water Mains, Service Pipes, Public Sewers and Lateral Drains pursuant to a duty imposed on the undertaker by the Water Industry Act 1991, whether by requisition (under sections 41(1), 98(1) or 98(1A)), under an agreement for adoption (under sections 51A or 104),

pursuant to section 45(1) (Duty to make connections with main) or in accordance with another duty imposed by the Act, or in consequence of the exercise of rights under section 106(1) (Right to communicate with public sewers). It also includes the additional capacity in any earlier water main or sewer that falls to be used in consequence of the provision or connection of a new main or sewer.

m) "**New Appointee**" means a company holding an appointment as a relevant undertaker where the conditions of that appointment limit the charges that can be fixed under a charges scheme by reference to the charges fixed by one or more other relevant undertakers.

n) "**Non-contestable Work**" means work or services that only the relevant undertaker (or an agent acting on their behalf) can do or provide.

o) "**Public Sewer**" means a sewer for the time being vested in a sewerage undertaker, whether under the Water Act 1989, the Water Industry Act 1991 or otherwise.

p) "**Service Pipe**" means so much of a pipe which is, or is to be, connected with a water main for supplying water from that main to any premises as — (a) is or is to be subject to water pressure from that main; or (b) would be so subject but for the closing of some valve, and includes part of any service pipe

q) *"***Sewer***"* includes all sewers and drains (not being drains within the meaning given by section 219(1) of the Water Industry Act 1991) which are used for the drainage of buildings and yards appurtenant to buildings

r) "**Site Specific"** refers to work on, or the provision of, water or sewerage structures or facilities located on a Development as well as work to provide and connect a requested Water Main, Sewer, Communication Pipe or Lateral Drain on, or in the immediate vicinity of, the Development and "**Site Specific Work**" shall be construed accordingly. It does not refer to costs or work required as part of **Network Reinforcement** as defined above.

s) *"***Undertaker***"* means a water undertaker or sewerage undertaker.

t) "**Water Main**" means any pipe, not being a pipe for the time being vested in a person other than the undertaker, which is used or to be used by a water undertaker or licensed water supplier for the purpose of making a general supply of water available to customers or potential customers of

the undertaker or water supply licensee, as distinct from for the purpose of providing a supply to particular customers. This definition includes tunnels or conduits which serve as a pipe and to any accessories for the pipe.

6. Unless the contrary intention appears, words and expressions used in these rules have the same meaning as in any provision of the Water Industry Act 1991.

Consultation

7. Undertakers must determine what types of charges covered by these rules may or may not be imposed, and the amount of such charges, in accordance with the principle that changes to charges covered by these rules should only be made after proportionate, timely and effective consultation with groups of persons likely to be significantly affected by the proposed Charging Arrangements (or their representatives) and any other persons the undertakers consider it appropriate to consult.

Publication and Transparency

8. Relevant undertakers must publish charges developed under these rules in a single document (the Charging Arrangements). The Charging Arrangements must be published on the undertaker's website and in any other manner the undertaker considers appropriate for the purpose of bringing the Charging Arrangements to the attention of persons likely to be affected by it.

9. The maximum amount of any charge that may be imposed by an undertaker under the provisions of the Water Industry Act 1991 covered by these rules shall be the amount set out in, or calculated in accordance with, the Charging Arrangements published by that undertaker. For the avoidance of doubt, the charges and charging methodologies set out in the Charging Arrangements must therefore include relevant miscellaneous and ancillary costs such as assessment, inspection, design, legal and supervision charges that the undertaker is entitled to recover, unless there is a different legal basis for the recovery of such costs.

10. The Charging Arrangements must be published no later than two months before the period in relation to which they have effect. Charging Arrangements must be published at least once in every year from 2017 onwards.

11. The Charging Arrangements must explain how each charge has been calculated or derived. Where an undertaker determines the applicable charges other than

by Fixed Charges, the methodology for the calculation of such charges must be explained clearly in the Charging Arrangements.

12. The Charging Arrangements are to be written and presented in a clear and accessible manner, which takes due account of the varying levels of expertise of all Developers or other customers who may rely on the Charging Arrangements. Undertakers should consider publishing worked examples where this could aid customers' understanding.

13. Charges must be published with such additional information or explanation as is necessary to make clear what services are covered by each charge.

14. Undertakers must publish the charges covered by these rules in such a way that a Developer or other customer can confidently work out a reasonable estimate of the charges payable if they know the relevant parameters of a Development site.

15. The Charging Arrangements must identify which charges are associated with Contestable Work and Non-contestable Work.

16. Undertakers must provide a reasonable choice of times and methods of payment of the charges and set these out in the Charging Arrangements.

New appointees

17. Paragraph 10 of these rules does not apply to new appointees. Instead new appointees must publish their Charging Arrangements no later than five weeks preceding the period in relation to which they have effect.

General charging principles

18. Relevant undertakers must determine what types of charges may or may not be imposed and the amount of any charges that may be imposed in accordance with the principle that charges covered by these rules should reflect:

    (a) fairness and affordability;
    (b) environmental protection;
    (c) stability and predictability; and
    (d) transparency and customer-focused service.

Principles for Determining the Nature and Extent of All Charges Covered by these Rules

19. In setting charges in accordance with the present rules, undertakers should take reasonable steps to ensure that the present balance of charges between Developers and other customers is broadly maintained. An undertaker may only depart from this general requirement where (and to the extent that) this is rendered necessary by circumstances providing clear objective justification for doing so. Any such justification must be clearly identified in any Charging Arrangements prepared pursuant to these rules.

20. Consistent principles and approaches must be applied to the calculation of charges for different classes of customer. For the avoidance of doubt, this includes the calculation of charges for Non-contestable Work, whether or not a person other than the undertaker is carrying out Contestable Work.

21. Charges (including any Income Offsets) and any Asset Payments must be set in accordance with the principle that they should promote effective competition for Contestable Work.

22. For the avoidance of doubt, in charges covered by these rules undertakers may recover reasonable administrative expenses and other overheads incurred in discharging any rights or obligations under the relevant provisions of the Water Industry Act 1991.

Charges for the Requisition of Water Mains and Public Sewers

23. Each undertaker shall set out in its Charging Arrangements charges that will be imposed by that undertaker for work carried out by it in accordance with the duties imposed by section 41(1) (provision of requisitioned Water Main) and section 98(1) (provision of requisitioned public sewer) of the Water Industry Act 1991 (together, "**Requisition Charges**").

24. These charges are concerned with the cost to the undertaker of providing Site Specific infrastructure necessary for the provision of a Water Main and/or Public Sewer.

25. In relation to Requisition Charges, an undertaker:

    a) must provide for the option of upfront Fixed Charges in respect of any work carried out by the undertaker; and

    b) may also provide for other alternative methods for calculating charges but, where it does so, each alternative method must be explained clearly in the Charging Arrangements.

26. Requisition Charges must relate to physical infrastructure required to provide the requisitioned Water Main and/or Public Sewer. Such charges may not include any amount for Network Reinforcement costs (in summary, the costs of providing such other infrastructure (including Water Mains or Public) as is necessary in consequence of the installation or connection of the requisitioned Water Main and/or Public Sewer).

27. Any Requisition Charges imposed by an undertaker:

    a) must relate only to Site Specific Work carried out and costs incurred by the undertaker in order to meet its duties under sections 41(1) or 98(1) of the Water Industry Act 1991; and

    b) must not relate to work needed or desired to modify or enhance existing network infrastructure in order to address pre-existing deficiencies, in capacity or capability, unrelated to requirements associated with the requisition.

28. Where an undertaker provides a Water Main or Public Sewer pursuant to a requisition and, in so doing, decides to increase the capacity of pipes or other infrastructure beyond that which is needed to meet the undertaker's duty under section 41(1) or section 98(1) of the Water Industry Act 1991, the costs of this work shall be apportioned so that the person making the requisition only pays costs which are in proportion to the particular capacity required by his or her requisition.

29. In setting Requisition Charges an undertaker may (but is not required to) provide for an Income Offset.

30. As regards the methodology for the calculation of Income Offsetting arrangements:

    a) Each undertaker has discretion as to the methodology to be applied to calculate Income Offset. Such methodology must, however, be clearly explained in the applicable Charging Arrangements;

    b) In addition as regards Water Mains, the methodology for the calculation of any Income Offset applied in respect of requisitioning charges must be equivalent to the methodology applied in calculating any Asset Payment an undertaker may make in respect of the adoption of Water Mains and

c) Nothing in these rules prevents an undertaker from providing for Income Offsetting arrangements in relation to the requisition of Public Sewers if it does not make any Asset Payments in respect of the adoption of Sewers. But if the undertaker does make Asset Payments in respect of the adoption of Sewers or Lateral Drains then the methodology for the calculation of any Income Offset applied in respect of Requisition Charges must be equivalent to the methodology applied in calculating any such Asset Payment.

Charges for the Provision of Lateral Drains, the Connection of Water Mains and Communications with Public Sewers and for Ancillary Works

31. Each undertaker shall set out in its Charging Arrangements charges that will be imposed by that undertaker for work carried out by it in accordance with the duties (or rights) created by the following provisions of the Water Industry Act 1991: section 45(1) (connection with Water Main); section 46(1) (ancillary works for purposes of making a domestic connection); section 98(1A) (provision of lateral drains); section 101B (construction of lateral drains following construction of a public sewer) or section 107(1) (right of undertakers to make communication with Public Sewer) (together, "**Connection Charges**").

32. In relation to Connection Charges an undertaker:

    a) must provide for the option of upfront Fixed Charges in respect of any work carried out by the undertaker; and

    b) may also provide for other alternative methods for calculating charges but, where it does so, each alternative method must be explained clearly in the Charging Arrangements.

33. Any Connection Charges imposed by an undertaker must relate only to Site Specific Work carried out and costs incurred by the undertaker pursuant to sections 45(1), 46(1), 98(1A), 101B or 107(1) of the Water Industry Act 1991.

34. Undertakers shall not provide for Income Offsets in setting Connection Charges.

Charges and Asset Payments in respect of an Agreement under Section 51A or 104 of the Water Industry Act 1991

35. Each undertaker shall set out in the applicable Charging Arrangements the charges to be imposed and the Asset Payments, if any, to be made in respect of an agreement under section 51A or section 104 of the Water Industry Act 1991.

36. These charges are concerned with the cost of Site Specific Work necessary as part of the adoption or connection of a Water Main, Communication Pipe, Public Sewer and/or Lateral Drain. Such charges may not include Network Reinforcement costs, that is to say, charges for providing such other structures or facilities (including Water Mains or Public Sewers) as is necessary in consequence of the installation of the adopted Water Main, Communication Pipe, Public Sewer and/or Lateral Drain.

37. Insofar as section 51A agreements are concerned, water undertakers shall provide for Asset Payments where the undertaker calculates the requisition charge for a Water Main to include an Income Off-setting arrangement.

38. Insofar as section 104 agreements are concerned, sewerage undertakers may provide for Asset Payments for the adoption of a Sewer.

39. Where an undertaker provides for Asset Payments in respect of the adoption of a Water Main pursuant to an agreement under section 51A of the Water Industry Act 1991, or the adoption of a Sewer pursuant to an agreement under section 104 of the Water Industry Act 1991, the calculation of any Asset Payment must be equivalent to the methodology applied in calculating an Income Offset applied in respect of Requisition Charges.

40. Undertakers shall not provide for Asset Payments for the adoption of a Communication Pipe or Lateral Drain.

Charges for Diversions of Pipes and other Apparatus under Section 185 of the Water Industry Act 1991

41. Each undertaker must set out in its Charging Arrangements its method(s) for calculating the charges imposed by that undertaker pursuant to section 185(5) of the Water Industry Act 1991 ("**Diversion Charges**"). In relation to Diversion Charges an undertaker:

    a) may provide for the option of upfront Fixed Charges in respect of any work carried out by the undertaker; and

    b) may also provide for other alternative methods of calculating charges but, where it does so, each alternative method must be explained clearly in the Charging Arrangements.

42. Charges levied pursuant to section 185(5) must be calculated by reference to the principle that the undertaker is only entitled to recover costs reasonably

incurred as a result of complying with the duty imposed by section 185(1) of the Water Industry Act 1991.

Security/Deposit Arrangements

43. An undertaker is allowed to require security prior to commencing work, whether in the form of a deposit or otherwise:

    a) under section 42(1)(b), 47(2)(a), 99(1)(b), 101B(3A), 107(3)(b)(ii) or 185(4); or

    b) for the purposes of any charges imposed under an agreement under section 51A or section 104 of the Water Industry Act 1991.

44. The type and amount of security should not be unduly onerous, taking into account the risk to be borne by the undertaker in carrying out the work in question. Where undertakers require security, the type and amount of security and the payment of interest on the security should reflect the general charging principles set out in paragraph 18.

45. The undertaker must clearly set out requirements for security in relation to any charges to be applied in its Charging Arrangements.

Annex: Information requirements

A1. Each undertaker should provide to the Water Services Regulation Authority an assurance statement from its Board of Directors and publish its statement no later than the time of publication of the their Charging Arrangements:

i. confirming that the company complies with its obligations relating to these Charging Rules

ii. confirming that the company has appropriate systems and processes in place to make sure that the information contained in the charges scheme, and the additional information covered by this annex is accurate

iii. how the present balance of charges between Developers and other customers is broadly maintained.

Appendix 2: Proposed revised charges scheme rules

Introduction

1. These rules are issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991.

2. The rules come into effect on [date to be inserted], replacing the rules that came into effect on 17 November 2015.

3. The rules apply to water undertakers and sewerage undertakers when they are making a charges scheme.

4. The rules are supplementary to statutory provisions that apply to relevant undertakers under any enactment, or instrument made thereunder (including the conditions of their appointments), and in the event of any conflict between the rules and any statutory provision, the latter shall prevail.

Interpretation

5. Unless the context otherwise requires, in these rules:

- "**charges scheme**" means a charges scheme under section 143 of the Water Industry Act 1991;
- "**Charging Year**" means a calendar year running from 1 April in a given year to 31 March in the following year;
- "**domestic premises**" means any premises used wholly or partly as a dwelling or intended for such use;
- "**Infrastructure Charges**" means the charges described in section 146(2) of the Water Industry Act 1991.
- "**metered charge**" means a charge for services that are based wholly or partly on measured quantities of volume;
- "**the Minister**" means –
- in the case of an undertaker whose area is wholly or mainly in England, the Secretary of State, and
- in the case of an undertaker whose area is wholly or mainly in Wales, the Welsh Ministers;
- "**Mogden formula**" means the following formula:

  Charge per unit of effluent = R + [(V + Bv) or M] + B(Ot/Os) + S(St/Ss)7
  where:
  R = reception and conveyance charge [p/m^3]
  V = primary treatment (volumetric) charge [p/m^3]
  Bv = additional volume charge if there is biological treatment [p/m^3]
  M = treatment and disposal charge where effluent goes to sea outfall [p/m^3]
  B = biological oxidation of settled sewage charge [p/kg]

Ot = Chemical oxygen demand (COD) of effluent after one hour quiescent settlement at ph 7
Os = Chemical oxygen demand (COD) of crude sewage one hour quiescent settlement
S = treatment and disposal of primary sewage sludge charge [p/kg]
St = total suspended solids of effluent at ph 7 [mg/litre]
Ss = total suspended solids of crude sewage [mg/litre]

- "**Network Reinforcement**" means work to provide or modify such other:

    i. water mains and such tanks, service reservoirs and pumping stations, or
    ii. sewers and such pumping stations

  as is necessary in consequence of the installation or connection of water mains, service pipes, public sewers and lateral drains pursuant to a duty imposed on the undertaker by the Water Industry Act 1991, whether by requisition (under sections 41(1), 98(1) or 98(1A)), under an agreement for adoption (under sections 51A or 104), pursuant to section 45(1) (Duty to make connections with main) or in accordance with another duty imposed by the Act, or in consequence of the exercise of rights under section 106(1) (Right to communicate with public sewers). It also includes the additional capacity in any earlier water main or sewer that falls to be used in consequence of the provision or connection of a new main or sewer;
- "**new appointee**" means a company holding an appointment as a relevant undertaker where the conditions of that appointment limit the charges that can be fixed under a charges scheme by reference to the charges fixed by one or more other relevant undertakers;
- "**rateable value charge**" means a charge fixed wholly or partly by reference to a rating valuation list or otherwise determined, whether directly or indirectly, by reference to any value or other amount specified at any time in such a list or which purports to be so fixed or determined;
- "**rating valuation list**" means a list which is or has at any time been maintained, for the purposes of rating, under section 41 of the Local Government Finance Act 1988, section 67 of the General Rate Act 1967 or any other enactment;
- "**service**" includes the supply of water; and
- "**unmetered charge**" means a charge for services that are not based on measured quantities of volume to any extent.

6. Unless the contrary intention appears, words and expressions used in these rules have the same meaning as in any provision of the Water Industry Act 1991.

Consumer Council for Water

7. Before making a charges scheme a relevant undertaker must consult the Consumer Council for Water about its proposed scheme in a timely and effective manner.

Bill stability

8. Undertakers should carry out a proportionate impact assessment whenever the nominal value of bills for a given customer type (assuming a constant level of consumption) is expected to increase by more than 5% from the previous year.

Publication

9. Charges schemes must be published no later than the first working day of the February immediately preceding the Charging Year in relation to which they have effect.

10. Charges schemes must be published on a relevant undertaker's website and in such other manner as the undertaker considers appropriate for the purpose of bringing it to the attention of persons likely to be affected by it.

11. Where a relevant undertaker has published or fixed standard charges otherwise than under a charges scheme for any services provided by that undertaker, charges schemes must state how customers may obtain a copy of such charges and, if applicable, where on a relevant undertaker's website those charges may be found.

Principles for determining the amounts of charges

12. Consistent principles and approaches must be applied to the calculation of charges for different classes of customers.

13. Charging structures must reflect the long run costs associated with providing the relevant service.

14. Charges for services provided to domestic premises must be fixed so that the average difference between metered charges and unmetered charges only reflects any differences in the costs of, and the additional benefits of, the provision of one service relative to the other;

15. Differences between charges for services provided to larger users of water and charges for services provided to smaller users of water must only be based on cost differences associated with differential use of network assets, differential peaking characteristics, different service levels and/or different service measurement accuracy.

16. Where cost differences associated with differential peaking characteristics are used as a basis for differences between charges for services provided to larger users of water and charges for services provided to smaller users of water, the charges fixed on that basis must be structured on an appropriate peak demand basis.

17. Charges for sewerage services must take into account the different pollutant loads associated with household foul sewage, non-household foul sewage, trade

effluent, surface water draining from premises and surface water draining from highways.

Assessed charges

18. Charges schemes must allow a customer to choose to pay an assessed charge determined in accordance with this rule in the specified circumstances:

    (a) The type and amount(s) of an assessed charge must be determined in accordance with the following principles:
        (i) assessed charges should, as closely as practicable, reflect the metered charges that would apply in relation to the volume of water that is likely to be supplied; and
        (ii) the amount of an assessed charge payable by an individual who is the sole occupier of domestic premises (a single occupier assessed charge) should reflect the volume of water that is likely to be supplied to domestic premises occupied by one individual in the relevant area.

    (b) The specified circumstances for the purposes of this rule are where a water undertaker has received a measured charges notice in accordance with section 144A of the Water Industry Act 1991 but was not obliged to give effect to it because:
        (i) it is not reasonably practicable to fix charges in respect of the premises by reference to the volume of water supplied; or
        (ii) to do so would involve the incurring by the undertaker of unreasonable expense.

Unmetered charges

19. Charges schemes that include any unmetered charges must clearly state the basis on which those charges are fixed or determined and, in the case of rateable value charges, state:

    (a) which rating valuation list charges are fixed or determined by reference to; and
    (b) if the undertaker uses a different value or other amount to that specified in such a list, the methodology or other basis on which that different value or other amount is calculated.

Wastewater charges

20. Sewerage undertakers' charges schemes must provide for a cost reflective reduction in the charges payable for the provision of sewerage services to any premises where the sewerage undertaker knows, or should reasonably have known, that surface water does not drain to a public sewer from those premises.

21. Sewerage undertakers must set out in their charges schemes how any reduction in the charges payable for the provision of sewerage services to any premises will be calculated if customers can demonstrate that they have significantly

reduced the volume of surface water draining to a public sewer from their premises or explain why there is no such provision.

Trade effluent

22. Charges to be paid in connection with the carrying out of a sewerage undertaker's trade effluent functions must be based on the Mogden formula, a reasonable variant of the Mogden formula or on a demonstrably more cost-reflective basis.

Social tariffs / Concessionary drainage charges

23. Charges schemes must state:

(a) whether or not undertakers have decided to include in the charges scheme:
  (i) provision designed to reduce charges to community groups in respect of surface water drainage from their property (having had regard to any guidance issued by the Minister under section 43 of the Flood and Water Management Act 2010);
  (ii) provision designed to reduce charges for individuals who would have difficulty paying in full (having had regard to any guidance issued by the Minister under section 44 of the Flood and Water Management Act 2010); and
(b) if any such provision is included, how eligible customers can apply for such reduced charges.

Times and methods of payment

24. Charges schemes must include provisions giving customers a reasonable choice as to the times and methods of payment of the charges fixed by the scheme.

New appointees

25. Rule 9 does not apply to new appointees. Instead new appointees must publish charges schemes no later than the 22 February immediately preceding the Charging Year in relation to which they have effect.

Infrastructure charges (English undertakers)

26. Each relevant undertaker whose area is wholly or mainly in England must fix Infrastructure Charges in a charges scheme.

27. Infrastructure Charges must be determined in accordance with the principle that the charges should reflect:
  (a) fairness and affordability;
  (b) environmental protection;
  (c) stability and predictability; and
  (d) transparency and customer-focused service.

28. Infrastructure Charges must be determined in accordance with the principle that the amount of such charges will over each period of five consecutive Charging Years ending on 31 March 2022 and, thereafter, on 31 March in each subsequent year cover the costs of Network Reinforcement that the relevant undertaker reasonably incurs, less any other amounts that the relevant undertaker receives for Network Reinforcement.

29. Charges schemes must include a clear methodology explaining how Infrastructure Charges have been calculated.

30. For the avoidance of doubt, Infrastructure Charges must not relate to the costs of reinforcing, upgrading or otherwise modifying existing network infrastructure in order to address pre-existing deficiencies in capacity or in capability unrelated to a requisition under sections 41(1) or 98(1), to the adoption of infrastructure under a section 51A or 104 agreement or to connections described in section 146(2) of the Water Industry Act 1991.

31. Infrastructure Charges may be set as a fixed charge per connection or calculated in accordance with a formula. As long as the difference between amounts is cost-reflective, the amounts of Infrastructure Charges may vary to reflect different circumstances and, in particular, may be different for different geographical areas.

32. In making charges schemes, each relevant undertaker must ensure that:

    a) Charges schemes clearly set out how Infrastructure Charges have been calculated;

    b) The amount of Infrastructure Charges applied in respect of the modification or redevelopment of existing buildings or premises is determined in accordance with the principle that the amount must take due account of any previous usage associated with the buildings and/or premises to which the charges are to be applied and be discounted accordingly; and

    c) Charges schemes clearly explain the methodology to be applied for determining a discount to reflect previous usage.

[Note: No changes are proposed to the Annex (Information requirements) to the charges scheme rules.**]**

Appendix 3: Draft Modification – Condition C (Infrastructure Charges)

Section 55(1) of the Water Act 2014 allows Ofwat to modify the conditions of appointment of a company appointed under Chapter 1 of Part 2 of the Water Industry Act 1991 to be a water or sewerage undertaker "where it considers it necessary or expedient to do so in consequence of provision made by or under" Part 1 of the Water Act 2014. This power may only be exercised within two years of the date the provision in question comes into force.

The revised charges scheme rules we are proposing to issue will set out new rules for the calculation of infrastructure charges from 1 April 2017 where the existing charging provisions for connections and new infrastructure are replaced with our proposed charging rules for new connection services. We are therefore consulting, in accordance with section 55(4) of the Water Act 2014, on a consequential licence modification to Condition C (Infrastructure Charges) that will:

- remove the current restrictions on the maximum amount of infrastructure charges from 1 April 2017; and
- provide that the existing restrictions on the maximum amount of infrastructure charges will continue to apply after 1 April 2017 in relation to connections where the existing charging provisions continue to apply under transitional arrangements.

This modification is only being proposed in relation to water undertakers and sewerage undertakers whose areas are wholly or mainly in England.

We consider the proposed licence modification to be necessary or expedient in consequence of provision made, in particular, by sections 16(2) and 17 of the Water Act 2014:

- Section 16(2) of the Water Act 2014 inserted sections 143B to 143E into the WIA91. Section 143B of the WIA91 allows Ofwat to issue rules about the statutory end-user charges schemes (which include infrastructure charges) made by water undertakers and sewerage undertakers under section 143 of the WIA91.
- Section 17 of the Water Act 2014 inserts sections 144ZA to 144ZD into the WIA91. Section 144ZA of the WIA91 (which is only in force in relation to water undertakers and sewerage undertakers whose areas are wholly or mainly in England) allows Ofwat to issue rules about (among other things) the charges that may be imposed by a relevant undertaker under:

- section 42(2)(a) of the WIA91 for the provision of new water mains; and
- section 99(2)(a) of the WIA91 for the provision of new public sewers.

We welcome comments on our proposed licence modification, including the wording of the illustrative example.

Proposed licence modification – illustrative example

This is an illustrative example of our proposed modification to Condition C (Infrastructure Charges). The actual wording of any licence modification we make might be different for some or all undertakers:

Insert after paragraph 15:

"16 Cessation of this Condition

16.1 Subject to sub-paragraph 16.2, this Condition (including the Appendix) shall cease to have effect on 1 April 2017 and shall not limit the amount of any Infrastructure Charge in respect of each Charging Year starting on or after that date.

16.2 This Condition (including the Appendix) shall continue to have effect in relation to a connection made on or after 1 April 2017 in the following circumstances:

(a) in relation to a Water Infrastructure Charge, if the amendments made by section 18 of the Water Act 2014 would not apply to the connection of the premises to a water supply; and

(b) in relation to a Sewerage Infrastructure Charge, if the amendments made by section 19 of the Water Act 2014 would not apply to the connection of the premises to a public sewer."