8 December 2016

Trust in water

Charging rules for new connections: decision document

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About this document

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

We formally consulted on our proposals and consultation-stage impact assessement from 27 July 2016 to 26 August 2016.

This document sets out our final position on:

- charging rules for new connection services; and
- revised charges scheme rules.

The modifications to the conditions of the appointments (licences) of water companies (ie the associated licence changes) will be progressed seperately in the new year.

The changes in this document affects water companies whose areas are **wholly or mainly in England** only.

[1] In this document, references to “water companies” mean companies holding appointments as water undertakers and/or sewerage undertakers under the Water Industry Act 1991.

Contents

Executive summary

Water companies have a duty to allow new connections to be made to their existing networks, including for new housing development. The UK government's ambition is for one million new homes to be delivered by 2020, suggesting demand for new connections may be significant in the coming years.

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, cost-reflective 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 publishing rules which introduce a new approach to connections charging for water companies whose areas are wholly or mainly in England. We do this using our new powers introduced by the Water Act 2014, having had regard to the relevant charging guidance issued by the Department for Environment, Food and Rural Affairs (Defra). For companies whose areas are wholly or mainly in Wales, we will consult and publish our rules next year, following the publication by the Welsh Government of final supplementary charging guidance to Ofwat on developer charges and other matters.

Our new approach marks a significant change from the past and one we expect to deliver major benefits to developers and other customers. 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**, because water companies will have more flexibility in setting their charges;
- benefit from **fairer charges**, for example, we will ensure that 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 and require revenues from infrastructure charges to balance, as far as reasonably possible, with relevant expenditure over a rolling five-year cumulative period;

- benefit from more **effective competition which can drive down costs, provide improved service levels and choice**, for example through ensuring charges work for self-lay providers and new appointees;
- be **protected from incidence effects because the balance of costs must remain broadly as it is now –** this requirement reflects the view of government, as set out in their guidance to us, that the current balance between contributions to costs by developers and bill payers should be broadly maintained;
- 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 water 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** (should it be appropriate for companies to make this).

Other customers will:

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

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

We want companies to take ownership of their relationship with their customers, which includes developers, and we want to see the right balance being struck between standardised and tailored, innovative charges. So we have amended our approach to implementing our rules so that they take practical effect from April 2018, rather than April 2017. This will:

- help ensure that the new charging regime is implemented in a way that takes full account of – and is responsive to – customers' views
- allow Water UK and the water companies in the sector to explore the possibility of a more harmonised approach to implementation, which would reduce the risk of arbitrary differences in companies' implementation, whilst still allowing companies to introduce innovative tariffs.

Our approach is supported by our strengthened impact assessment, where we give full and equal consideration to a wide range of options.

In response to stakeholders' views, we have made drafting changes to some of our rules to ensure they are clearer, more comprehensive and more proportionate. We will take forward the associated licence changes in the new year.

We will monitor the development of companies' charging arrangements, continue to engage with stakeholders and step in, if required. This approach does not preclude us mandating further standardisation or giving further guidance in future should the circumstances warrant it.

1 Introduction

Following our consultation, this document sets out our decisions on the implementation of new charging arrangements for new connections and other infrastructure services. Implementing these changes requires:

- introducing new charging rules for connection services;
- changes to our charges scheme rules (since infrastructure charges[2] – a key charge faced by developers[3] – are governed by these rules).

We will take forward the associated licence changes (licence condition C currently sets limits on the level of infrastructure charges) in the new year.

The document is structured as follows:

- Chapter 2: Background and Approach
- Chapter 3: Responses to our consultation
- Chapter 4: Next steps

We are also publishing:

- our final impact assessment as a separate annex to this document
- the charging rules for new connection services[4]
- the new consolidated charges scheme rules[5]

[2] As well as recovering any costs incurred in making connections to a water supply or a public sewer, water companies 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 Water Industry Act 1991). These charges are known as “infrastructure charges”.
[3] Throughout this document, we use the term ‘developer’ to refer to any business or individual whose buildings or premises require new water, wastewater or drainage services.
[4] Issued under sections 51CD, 105ZF and 144ZA of the Water Industry Act 1991.
[5] Issued under sections 143(6A) and 143B of the Water Industry Act 1991.

2 Background and approach

In this chapter, we provide an overview of:

- our strategy;
- government guidance;
- our policy development process; and
- the objectives and approach of our July proposals.

We set out the legal framework in our July consultation, so we do not repeat this here.

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.

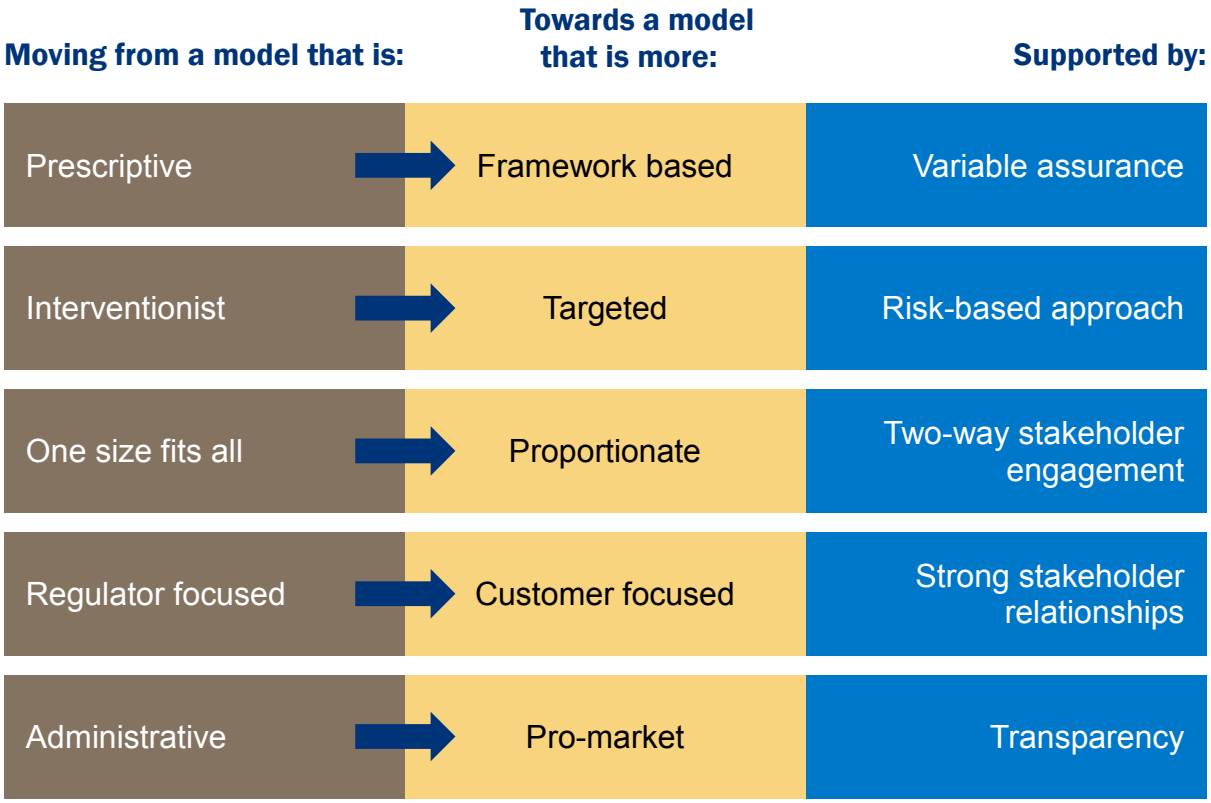
Getting charging right has a number of advantages to customers and others. It can do this through a number of means.

- **More cost reflective charges send better signals to enable and encourage efficiency.** 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 and enable faster delivery of services because time is not lost in seeking clarifications on how charges are to be applied.
- **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. (Changes in how costs are recovered through charges can create **winners and losers** which would need to be considered.)
- **Promoting effective competition for contestable developers' services.** 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 previous consultation documents, 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



2.2. Government guidance

In developing our charging rules for companies whose areas are wholly or mainly in England, we are required to have regard to relevant guidance that Defra has issued.

In January 2016, Defra published its overarching statement of charging policy and principles in Charging Guidance to Ofwat.

On 10 June 2016, Defra published its consultation Water industry: draft guidance to Ofwat for water and sewerage connections charges. This guidance sat under the high level principles set out in the January guidance. It contained further detail on the

charges for new connections that water companies, whose areas are wholly or mainly in England, may make to developers.

On 7 December 2016, Defra published its final charging guidance Water industry: guidance to Ofwat for water and sewerage connections charges along with a summary of responses to its draft charging guidance Consultation on the guidance to Ofwat for new water and sewerage connections charges: Summary of responses. There were no material changes to the principles in Defra's guidance from the version it consulted upon.

For companies whose areas are wholly or mainly in Wales, the Welsh Government published a consultation on draft Supplementary Charging Guidance to Ofwat on 21 November 2016, relating specifically to developer charges, bulk supply charges and access charges. The Welsh Government aim to issue their final guidance in the spring of 2017.

In making charging rules for water companies whose areas are wholly or mainly in Wales, we must have regard to relevant charging guidance from the Welsh Government and act in accordance with our other relevant legal obligations.

We expect to consult on draft rules and issue final rules for the companies whose areas are wholly or mainly in Wales next year. The existing framework will remain for companies whose areas are wholly or mainly in Wales until it is replaced by charging rules.

2.3. Our policy development process

During 2016, Defra convened a series of Task and Finish groups with active engagement from developers, water and sewerage companies, self-lay representatives, us and others. We have co-chaired some of these meetings and led discussions where these were directly relevant to the charging rules themselves. We have engaged in a series of meetings with key stakeholder groups where additional engagement was judged necessary, for example with self-lay providers, new appointees and the Consumer Council for Water (CCWater).

Notable milestones and events regarding our policy development process are as follows.

- 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.
- On 8 February 2016, Water UK hosted an event to consider charging issues.

- In March 2016 we consulted on our emerging thinking for rules for new connections.
- In July 2016 we consulted formally on our proposals (summarised in the following section).

2.4. Overview of our July proposals

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.

Figure 2 below summarises our July proposals. Annex 5 discusses how our rules address known issues.

Figure 2: Summary of our July proposals

Objective	Our July proposals
Fairness and affordability	**Not to set a rule that requires the 12-year income deficit approach**. **Require water companies to publish their proposed approach of balancing costs between developers and customers**. Such proposals would need to be informed by engagement between companies and their key stakeholders. Any substantial changes from the current balance would need to be accompanied by strong objective justification so as to be seen as legitimate by stakeholders[6].

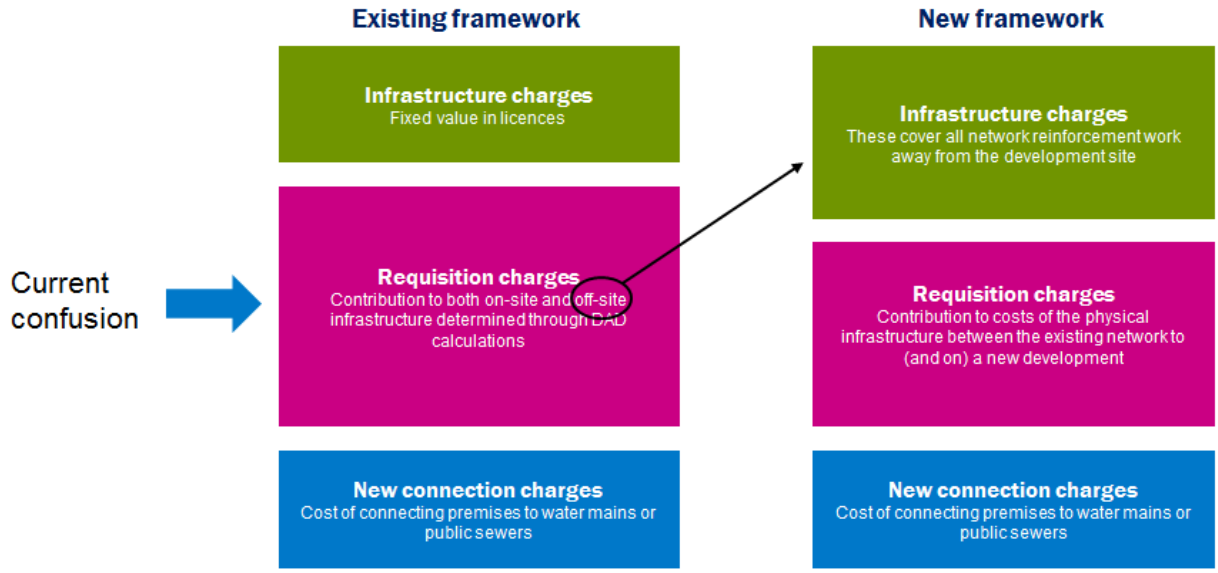
[6] This requirement reflected the view of government that the current balance between contributions to costs by developers and bill payers should be broadly maintained

Objective	Our July proposals
	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.
	Infrastructure charges **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 would **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** as a consequential licence change under section 55 of the Water Act 2014. **Expect water companies to cross-check their new charging approaches against the current framework, in terms of where costs are recovered from, to demonstrate that the current balance of charges between customers and developers is broadly maintained.** 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. The differences in approach between the current water and wastewater charging frameworks are arbitrary. We therefore considered whether there was 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 to 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 self-lay provider.
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.

Objective	Our July proposals
	Over the longer term, we see there could be benefits of further sector-wide standardisation in the structure of charges. Our preference was for this to be sector led (within the parameters of their obligations under competition law). But if we did 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 we will seek to strengthen this requirement in future years.

Figure 3 below summarises the changes in the structure of charges brought about by our rules.

Figure 3: Change in the structure of charges



3 Responses to our consultation

3.1. Introduction

This section summarises the responses to our July consultation and our consideration of these. The list of respondents is set out in Annex 2. As we are publishing all non-confidential responses alongside this document, we do not attempt to summarise them in detail below. Instead, our approach to this chapter is as follows:

- we provide a brief overview of the responses to each of the questions we asked. In some cases, stakeholders made general comments under a specific question. In these cases, we discuss the points made under the question heading that we consider most appropriate; and
- we provide our view and a more detailed description of stakeholders' views on an issue where either:
  - there is an update or clarification to our position; and
  - we have not previously explained our position on a particular topic, but we judge there is significant interest from stakeholders for us to do so.

We note that there were a number of suggestions for more detailed rules. We have considered all suggestions on their merits. In general, we were not satisfied that it would be appropriate to take our rules in that direction as it would undermine the value of a principles-based, outcome-focused approach. We note though that:

- the work Water UK is leading on how to take forward issues related to new connections charges may be helpful for considering appropriate ways to implement our rules;
- we may consider further guidance or changes to our rules in future, if appropriate; and
- there may be a degree of learning from experience, and as possible disputes are settled in future.

3.2. Retaining the key features and approach of our March proposals

Question 1: In light of our updates and clarifications, do you agree that we still retain the key features and approach of our March proposals?

The majority of stakeholders agreed we had retained the key features and approach of our March proposals.

Our position on standardisation and innovation

Our view is that:

- we still see the value of standardisation, but we consider that there are high risks in imposing high levels of standardisation at this point. This is because high levels of standardisation would require us to prescribe the same structure of charges across all companies prior to companies having the opportunity to innovate and develop better charging structures under the new regulatory framework. Excessive standardisation may also result in abrupt changes to charges. We do not propose to prescribe a standardised approach at this point, but encourage the sector to work with developers to move towards standardisation; and
- our proposed additional, transitional year will help facilitate the sector – working with developers – to lead on developing an approach to standardisation, but without fettering companies' ability to introduce innovative tarrifs.

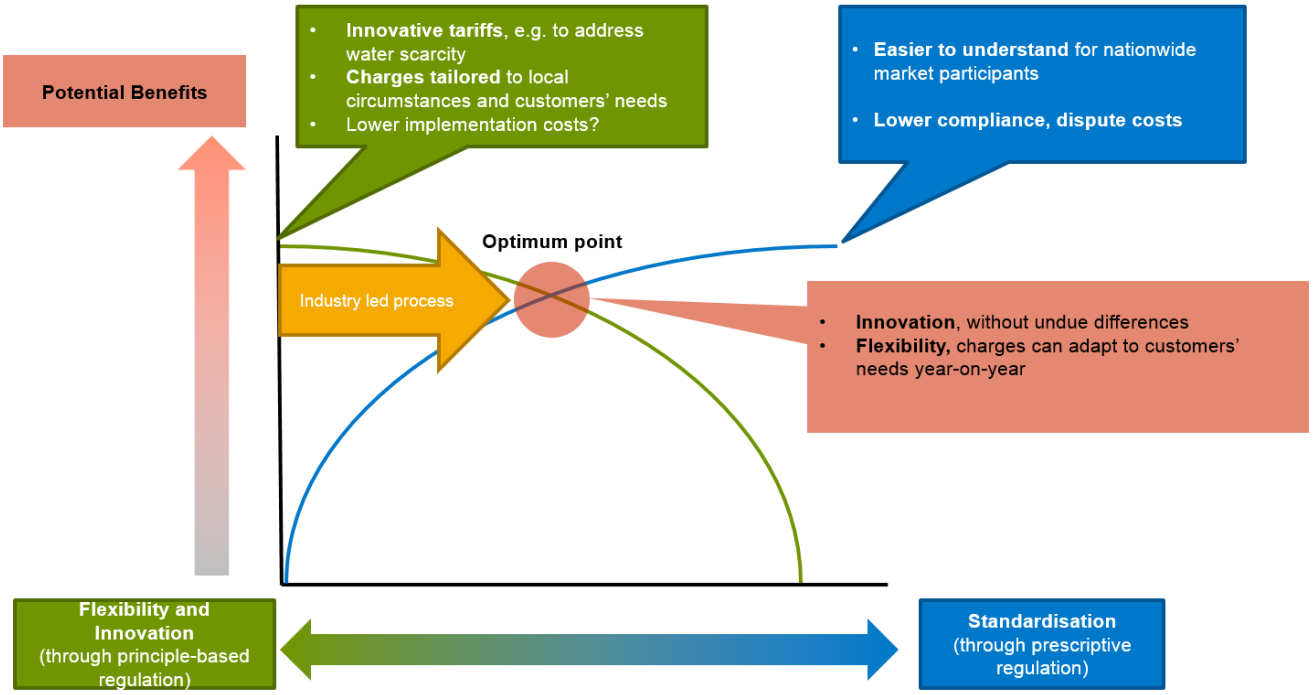
Where there was disagreement with question 1, it was almost entirely to do with the perceived loss of emphasis on standardisation. Some respondents said that this was an approach that would leave developers dissatisfied.

We see the value of standardisation, but do not believe our rules should fetter innovation at this stage. Our objective remains the same as that in our March document. We believe a degree of sector-led standardisation (within the parameters of water companies' legal obligations, including competition law) may help to achieve an optimal mix of standardisation with scope for innovation which would be difficult or impossible to achieve through prescriptive regulation. For clarity, we show this in figure 4.

Our proposed additional, transitional year (discussed later in this document) will help facilitate such a sector-led approach to standardisation. If there is no sector-led

progress towards standardisation, we could choose to set more prescriptive rules that require this, if it was appropriate to do so. We will initially review the sector's progress during March 2017 and take a view then whether any updates to our rules are required in advance of the implementation date of April 2018.

Figure 4: The trade-off between innovation and standardisation



To reach the optimum point, companies engage with all the relevant stakeholder. The Water UK work to help bring about standardisation can help the sector achieve this.

Our view is supported by our strengthened impact assessment, where we give full and equal consideration to a wide range of options. This analysis shows that our proposals allow for greater innovation and flexibility than introducing more standardised, prescriptive charging arrangements. Our impact assessment is discussed in more detail below and in annex six.

3.3. Updates and clarifications to our proposed rules

Question 2: Do you agree with our updates and clarifications to our proposed rules?

In our July consultation we provided a number of updates and clarifications to the proposals we set out in our March discussion document. These included, for

example, addressing specific questions raised as part of the previous consultation, changes to the rules to make them clearer and better targeted, guidance on interpretation of the rules and our proposed implementation.

Stakeholders responses to this question were mixed. Water companies on the whole agreed with our updates and the main issues they raised were around seeking further, minor clarifications on our rules. Other stakeholders also sought clarity on our rules, but in some cases also raised a range of other concerns, for example, that the changes did not go far enough, were unnecessary or were too complex. Key issues are discussed in more detail below.

3.1.1 Negative infrastructure charges and other adjustments

Our view is that:

- our rules do not prevent discounts of more than 100% to infrastructure charges.

Thames Water said it would be helpful if we made clear that water companies could offer more than a 100% infrastructure charge discount in circumstances where a developer is prepared to provide environmental protection which benefits more than just their development (i.e. a developer is prepared to benefit another development underway, or one which is likely to start in the future).

Our rules are not intended to – and do not – unduly get in the way or limit innovative charges. There is no rule which specifically prevents a company from offering a discounts of more than 100% (although water companies will need to ensure that doing so would be consistent with our charging rules more generally).

We note there are alternatives to discounts of more than 100% that could achieve the same objectives. We would expect companies to have considered these in deciding on a charge that involves a discount of more than 100%, as such an approach could create perverse incentives.

3.1.2 Application of our rules to small water companies

Our view is:

- that we will make our rules clearer and more proportionate in how they apply to small companies.

SSE suggested that our rules could be strengthened by:

- making it clear they cover the timing and profile of payments;
- removing ambiguity as to new appointees' roles in setting infrastructure charges; and
- considering the proportionality of the publication arrangements for new appointees.

Albion Water said our requirements to publish developer charges do not reflect the nature of new appointees.

All water companies (including small companies such as new appointees) already have an obligation to publish their infrastructure charges in charges schemes (licence condition D). In addition, even if the existing cap on infrastructure charges in licence condition C were removed, other regulatory requirements would still have the effect of capping new appointees' infrastructure charges by reference to the level of the infrastructure charges set by the water company (or water companies) they replaced.

We recognise that small companies (including new appointees) will receive far fewer requests for a new connection or for other infrastructure services (and could potentially receive no requests for certain services in a given year). Therefore, we have introduced a new rule to provide small companies with more flexibility regarding what or when certain information should be published. Our approach ensures that customers can still benefit from the same protections (for example, that the same principles and requirements apply to the calculation of charges, whether or not they are published) and still requires small companies to set their charges in accordance with the principle that changes to charges covered by the rules should only be made after proportionate, timely and effective consultation.

3.1.3 Modelling of foul sewerage capacity

In our view:

- our rules will help ensure there is predictability and transparency of charges; and
- we expect water companies to continue to work with their developer services customers to ensure the modelling assumptions they are using are transparent and well understood.

The Home Builders Federation (HBF) asked that our rules state clearly what is acceptable in terms of foul sewerage capacity modelling and how it is used to determine equitable and proportionate developer contributions.

Our rules will help remove any existing lack of transparency and predictability of developers' charges which arises due to the approach water companies may take to their foul sewerage modelling. Our rules require:

- that where a water company 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; and
- that water companies must publish their charges 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.

Water companies have been working with the HBF to address their concerns. Discussions on this topic have regularly formed a part of the Defra-convened Task and Finish Group meetings. We understand that the National Joint Industry Development Committee discussions with the HBF will continue and will provide a forum for highlighting any further concerns regarding differences of approach. We also note that Water UK and the water companies are planning to continue to take this work forward, as a 'satellite task' to their implementation plan during the proposed additional, transitional year.

We do not have the legal powers to determine water companies' approaches to foul sewerage capacity modelling as part of our charging rules. However, we expect water companies to work with their developer services customers to address their concerns and ensure the modelling assumptions they are using are transparent and well understood.

3.1.4 Water company obligations under sections 37 and 94 of Water Industry Act 1991

In our view:

- It is not necessary or appropriate for charging rules to try and define the scope of water companies' obligations under specific provisions of the Water Industry Act 1991.

The HBF considered that our rules must set out and define exactly what the water companies' obligations are under sections 37[7] and 94[8] of the Water Industry Act 1991 and how they should interpret these duties. The HBF's view is that water companies have sole responsibility for the works necessary to fulfil their obligations in these sections and that this should not be funded by developers. And that these obligations also require water companies to invest ahead of need and ensure infrastructure is in place ready for new developments.

The House Builders Association (HBA) were of the view that there has been a lack of investment to meet local planning need in the past and so many developers will be asked to fund underinvestment as well as future investment.

Water companies do have the responsibility for fulfilling these statutory duties, but sections 37 and 94 of the Water Industry Act 1991 do not prescribe how they should be funded for doing so, or prescribe when specific works required to fulfil the duties should take place. Water companies' fulfilment of these statutory duties is currently funded through a combination of both developer charges and charges collected from current and future billpayers.

Defra's guidance to us for developing these rules is clear that the broad balance of charges between developers and billpayers should stay the same. We have incorporated that principle into our rules and asked companies to explain in their assurance statements how this balance is broadly maintained.

Our rules clarify, for the purpose of setting charges, the boundary between those reinforcement works required to accommodate growth in demand as a result of new developments (that are to be funded by developers) and other necessary reinforcement works on the existing network (that are to be funded from bill payers). In other words, they seek to define how deep into the network developer charges should go. We therefore do not consider it appropriate or necessary to further

[7] Section 37 discusses among other things, each water undertaker's duty to develop and maintain an efficient and economical system of water supply within its area and to ensure that all such arrangements have been made (a) for providing supplies of water to premises in that area and for making such supplies available to persons who demand them; and (b) for maintaining, improving and extending the water undertaker's water mains and other pipes.

[8] Section 94 discusses among other things, each sewerage undertaker's duty to (a) provide, improve and extend such a system of public sewers (whether inside its area or elsewhere) and so to cleanse and maintain those sewers and any lateral drains which belong to or vest in the undertaker, as to ensure that that area is and continues to be effectually drained; and (b) to make provision for the emptying of those sewers and such further provision (whether inside its area or elsewhere) as is necessary from time to time for effectually dealing, by means of sewage disposal works or otherwise, with the contents of those sewers.

prescribe which specific activities should be funded by developers and which by existing customers.

Our rules provide definitions of site specific and network reinforcement work, so provide clarity for the purpose of setting charges. We believe that the future discussions that will take place under the guidance of Water UK, can help to further address the HBF's concerns through establishing clear definitions of the charges developers are expected to pay.

3.1.5 Planning

In our view:

- neither Ofwat nor water and sewerage companies have a decision-making role in the statutory planning system. Decisions about planning consents and any related conditions (including their precise wording) rest with the relevant local planning authority (LPA), subject to an appeal process.

The HBF considered that our rules will not stop water companies relying on the planning system to resolve pre-existing network problems or foul sewer capacity issues at the developer's expense.

Like any interested party, water companies are able to submit their views on individual planning applications being considered by a LPA. We are aware that some LPAs ask for the the views of local water or sewerage companies when considering planning applications, in particular to satisfy themselves that a development site can be effectively drained (as required by the planning process). In some cases this can result in the LPA deciding to include a planning condition requiring the agreement and/or implementation of a drainage strategy ahead of commencement or occupation of the development. We expect companies to work proactively with developers and LPAs to find an appropriate and timely solution to both the discharge of such conditions and to enable developments to connect to the network.

We are aware that in some circumstances, developers are asked to contribute to network reinforcement works by means of an agreement. Ofwat has no role in relation to such agreements. We do not consider that there is any provision in the Water Industry Act 1991 that prohibits a water or sewerage company from receiving funds from a developer to carry out its functions if they are prepared to make a contribution. However there is no obligation on it to do so.

3.1.6 Pipe diversions under section 185 of the Water Industry Act 1991 and asset betterment

In our view:

- we do not propose changing the rules at this stage in relation to what should or should not be included in the charges for diversions; and
- we invite stakeholders to share with us their views and any substantive evidence they have, to confirm or otherwise, that a water company has recovered more than it reasonably should have for diversion work.

Fair Water Connections, Energetics Design and Build and the HBF considered that because diversion work involves the replacement of older infrastructure with new infrastructure, water companies gain from acquiring new assets. Water companies should therefore reduce their charges to developers to recognise the 'asset betterment' they receive, as they do when mains and sewers are diverted for highway works. The HBF asked that this term and a discount methodology be defined in our rules.

The rules say that charges must be calculated by reference to the principle that a water company is only entitled to recover costs reasonably incurred. We expect companies to consider giving credit for asset betterment where appropriate to do so. We acknowledge the concerns raised in the submissions, but do not yet have sufficient evidence that further regulation is required to address this issue or that this would be a proportionate response to any problem. We note that Defra's charging guidance says that it is the view of government that the current balance between contributions to costs by developers and bill payers should be broadly maintained.

We therefore invite stakeholders to submit their views to us on this issue, with any substantive evidence they have that confirms or otherwise, that water companies (and bill payers) are materially benefitting from asset betterment through diversion work associated with new developments. Please send your responses to paul.fox@ofwat.gsi.gov.uk and copied to charging@ofwat.gsi.gov.uk.

We will consider this issue and any updates that are required, alongside the work we will carry out monitoring and reviewing industry progress in the transitional year and issuing final guidance for companies whose areas are wholly or mainly in Wales.

3.4. Offseting the infrastructure charge

Question 3: 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?

In our view:

- we can see merit in any income offset being offset against the infrastructure charge, rather than the requisition charge;
- however, our current intention is not to require this change during the current price review period (2015 to 2020), due to our concerns about the potential impact on existing customers; and
- therefore, we will consider making a change to our rules in future.

Currently, requisition charges can be reduced by an 'income offset' which is based on the expected flow of revenue over a twelve year period from new customers being connected to the water companies' network. As discussed in our July consultation, a number of concerns were raised by stakeholders regarding the application of income offsets and asset payments related to them. The key concerns raised were that:

- not all companies make asset payments available to new appointees, even though from an competition perspective, there should be no obvious reason for treating them differently from self-lay providers; and
- self-lay providers said that, amongst other things, more transparency is needed over asset payments as companies currently cannot always justify them when challenged.

A potential remedy put forward through our stakeholder engagement was to apply the income offset against the infrastucture charge instead of the requisition charge. As discussed in our July consultation, 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)[9]. It could therefore bring about the benefits of:

[9] This means self lay providers would not be disadvantaged by the removal of the asset payment.

- addressing self-lay providers' 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 providers (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
- potentially improve the stability of charges by reducing the increase in infrastructure charges and fall in requisition charges brought about by our new rules.

However, we also said that alhough 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. 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 the form of the wholesale price controls). Therefore, we said we were concerned that these changes would come at a cost to existing customers.

In general, more respondents to our July consultation supported offsetting the infrastructure charge, than the requisition charge. Particular issues with how such a change could be implemented covered interactions with the current price controls (as discussed above), as well as concerns about how such an approach would work for wastewater (where there is currently a low level of requisitioning). The HBF and HBA wanted to understand the proposal better before they could support it.

Changes should be implemented when:

- new appointees and self-lay providers, where they supported a change, were generally keen to implement the policy before 2020;
- CCWater raised concerns about the potential impact on existing customers, in practice meaning they opposed the change being made during this price review period; and
- water companies had mixed views.

We have decided that any changes should not be made during this price review period (ie before 31 March 2020).

We plan to consider introducing this change from April 2020 in future. We may consult on this option around the same time we are consulting on charging rules for new connections for water companies whose areas are wholly or mainly in Wales. This approach will allow time to consider this issue in more detail and allow further consultation on any changes in our rules, before implementation.

3.5. Implementation

Question 4: Do you have comments on our proposed approach to implementing our rules?

Around half of the respondents were largely happy with our proposed approach to implementation, whilst the other half raised a number of issues or questions which we address below.

Additional transitional arrangements

Our view is:

- that our charging rules (and related licence changes) should be implemented for April 2018, rather than April 2017.

A number of stakeholders, including representatives of customers and self-lay providers, requested more time for the sector to implement our proposed charging rules. The HBF and a self-lay provider proposed a start date of April 2018.

On 6 October we published a notice informing stakeholders of our decision to delay implementation and consulting on a start date of April 2018. Only two stakeholders responded to this - South West Water and CCWater - who both supported the proposed date.

Having considered responses to both our July and October consultation, we now judge that allowing an additional, transitional year is in the interests of customers. Given significant changes, transitional time would allow:

- appropriate time for water companies to consult and to respond to feedback, before their charges are finalised; and
- Water UK and the water companies to explore the possibility of a collaborative approach to implementation – this could help de-risk and avoid needless

differences in water companies' implementation to the benefit of developers, whilst still allowing water companies to introduce innovative tariffs.

This approach, therefore, provides an opportunity to help address some stakeholders' desires for standardisation, whilst also ensuring water companies retain ownership of their charging arrangements and the customer relationship in developing them.

By allowing more time for water companies to develop their proposals with customers, we also believe this will help allay CCWater's concerns around our other transitional measures – i.e. their concern that eligible customers will have limited time to consider which charging regime to choose.

Company Monitoring Framework

In our view:

- we expect water companies to conduct proportionate, timely and effective consultation during the additional, transitional year.

Some stakeholders said water companies should consult on their Charging Arrangements in a timely manner, so that there was sufficient time for consultees to respond fully and for water companies to then adjust their approach in light of this feedback. A number of water companies said we should not require implementation for April 2017 to allow them sufficient time to undertake effective consultation.

Given stakeholders' views, we expect water companies to initiate their consultations as soon as is practicable. We will be monitoring water companies' approaches to consulting stakeholders on charging policy. We have a range of regulatory tools to promote good assurance and engagement. We expect to include water companies' approaches to consultation and engagement during the transitional period in the Company Monitoring Framework assessment next year. Under the company monitoring framework, companies' overall assurance categorisation will determine the amount of prescriptive assurance that we require from them. The Company Monitoring Framework is designed to provide an 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.

Additional safeguards

In our view:

- we remain commited to a framework-based, proportionate and targeted approach to regulation and the principle that water companies should take ownership of their charging arrangements and their relationship with their customers. However, we will remain engaged and closely monitor implementation during the additional, transitional year. And we stand ready to take enforcement action, where this is in the interests of customers;
- as stated in the July consultation, our rules do not prevent piloting of new charging arrangements; and
- we will review the sector's progress during March 2017 and take a view then whether any updates to our rules are required in advance of the implementation date of April 2018.

MA Infrastructure said that appropriate testing, piloting and evaluation of new charges were important, before they were rolled out widely.

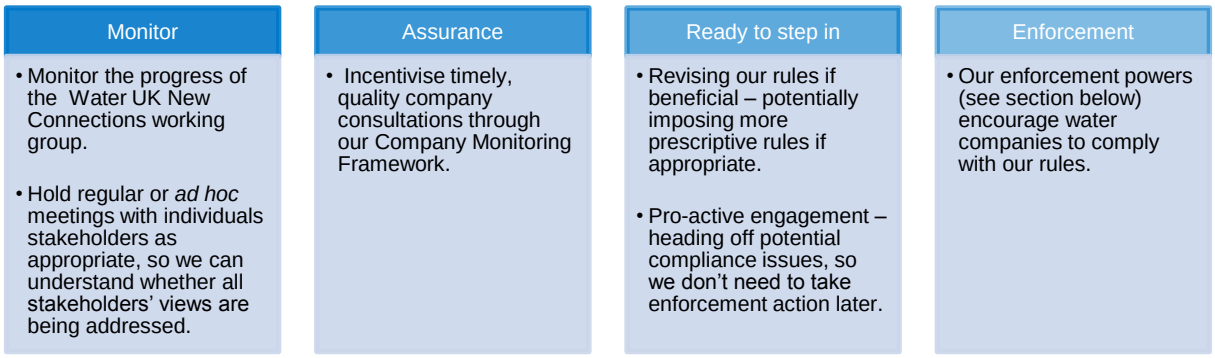
Fair Water Connections and Energetics Design and Build raised concerns about whether we had put in place adequate safeguards around water companies' implementation. They were concerned at the lack of requirements for companies to:

- undergo a formal consultation process;
- publish draft charging arrangements prior to implementation; or
- do an impact assessment and to approve charging arrangements with Ofwat.

They also had concerns over tight timescales if new charging rules are implemented in April 2017. We address these concerns as our rules also require companies to consult in a timely manner with stakeholders before publishing their charging arrangements which must be done prior to implementation. As we are allowing an additional transitional year this will give sufficient time for consultation and sight of new charging arrangements.

We also recognise that, even with the additional, transitional arrangements stakeholders may still have residual concerns. We expect the water companies and their stakeholders to work together effectively. That said, our strategy for helping to ensure effective implementation during the additional, transitional year is set out in figure 5. We will only step in if necessary. We will review the sector's progress during March 2017 and take a view then whether any updates to our rules are required in advance of the implementation date of April 2018.

Figure 5 Our role during the additional, transitional year



Enforcement

Our view is that:

- where there are concerns that a company's charges for new connections do not comply with the rules we have set out, we have powers to take enforcement action by issuing enforceable directions (which might, for example, require water companies to change their charges); and
- once the relevant parts of the Water Act 2014 are brought into force by Defra, we will still have powers to resolve disputes between a customer and a company over the costs of individual connections and requisitions. However we will not have powers to resolve individual disputes over infrastructure charges or charges associated with requests to relocate (divert) existing water and sewer mains.

In our July consultation we said that, once the relevant parts of the Water Act of 2014 are commenced by Defra, we will not have powers to determine disputes over the appropriate infrastructure charges for properties that are connected to the public mains and / or 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 their responses, some people said that they had concerns that Ofwat will not be able to determine disputes over some charges such as infrastructure charges. Stakeholders raised concerns over the costs of taking such disputes to be resolved through a courts system. Bristol Water also suggested that there would be benefits if Ofwat could have an initial oversight role in charging disputes as there is predicted to be an increase in the number of disputes during this transition period.

CCWater also raised concerns that we had not set out any indicative timescales for dealing with disputes. We have since published our timeframes for handling these and other types of cases on our website.[10]

Finally, the HBA raised a concern that Ofwat is not setting an upper limit on, or issuing guidance on what is a reasonable charge. It believes that this leaves customers without a means for redress if they feel that the charges are too high. CCWater raised similar concerns about whether the new rules will be sufficient to ensure that water companies are not 'gold-plating' the requisition element of the charges.

Our powers to make determinations on disputes are set out in the Water Industry Act 1991 and are not a function of our charging rules. As a result, we are not able to use the new rules to decide what types of disputes we can determine.

Under the new rules, water and sewerage water companies will be required to develop their new connections charges in consultation with their customers. This will provide customers with an opportunity to highlight concerns with their approach to applying charges during their development. We are also requiring water companies to set charges that broadly maintain the current balance of costs between new and existing customers. Finally, with the exception of infrastructure charges and requests to move existing water mains and sewers, customers will still be able to refer disputes over the size of any charges to Ofwat. Overall, this will ensure that customers are protected from any unreasonable charging by water companies.

Monitoring and reporting working group

We will:

- take forward work related to the monitoring and reporting through a dedicated working group.

A number of respondents commented on the monitoring and reporting of the five year rule, (ie the balancing of revenue and costs as far as possible over a rolling five year period), and whether the data collected would achieve the intended objectives.

[10] http://www.ofwat.gov.uk/wp-content/uploads/2016/09/Our-timeframes-for-handling-cases.pdf

One respondent also queried whether the scope should be widened to include other areas of grants and contributions.

We have established a working group to look at these issues. This group comprises a number of water companies and representatives of the HBA, HBF and Fair Water Connections. Our intention is to work up proposals for consutation on regulatory reporting for the 2018-19 reporting year.

3.6. Impact assessment

Question 5: Do you agree with the approach we have taken for our draft impact assessment? Can you provide the quantitative figures in terms of the potential benefits or costs? Is there anything we have missed?

Stakeholder responses to this question were mixed. Water companies and new appointees tended to support the approach we took in our draft impact assessment. Organisations representing developers and self-lay providers thought, amongst other things the impact assessment should:

- be strengthened further;
- needed to include quantitative data;
- have more assessment on the impacts on different groups; and
- further options needed to be considered.

We received no quantitative figures in terms of the potential benefits or costs in response to our request. So during October we requested information from a wide range of stakeholders, as part of this we set out a template along with guidance on the kinds of information we thought would be helpful. We are grateful to all the stakeholders who responded to our information request.

Our updated impact assessment is published as a separate annex to this document, which discusses this in more detail. It now uses quantitative data to assess four options:

- ‘do nothing’ – ie maintaining the status quo;
- a ‘de-regulation’ option;
- a ‘principle-based’ option – our preferred option; and
- a standardised, prescriptive option.

In summary, it finds that our our proposed approach (the 'principle based option') is the most cost effective (compared to 'do nothing') when we take monetised and non-monetised costs into account. It is also the most beneficial – scoring most highly in terms of meeting our objectives, addressing known issues and practicality.

3.7. Drafting comments

Question 6: Do you have any comments on the drafting of our new connections rules?

Question 7: Do you have comments on the draft changes to the charges scheme rules?

Question 8: Do you have any comments on the drafting or our proposed licence modification, including the wording of the illustrative example.

We received a number of comments related to our proposed drafting. Most comments were directed towards our new connections rules, whilst the drafting of the proposed licence modification received comments from very few stakeholders.

Comments were generally to do with how to improve the clarity and completeness or our rules, as well as how to reduce the scope for misinterpretation and needless disputes. Some drafting comments sought a change or significiant widening of our rules.

We have set out the original and amended text in annexes three and four, where we have decided to make a change in light of stakeholders' responses.

Tailoring approaches to different classes of customer

Our view is that:

- we should clarify that our rules ensure water companies must consider different types of customer – including small-scale and individual developers; and
- we should clarify that our rules do not require water companies to set a flat infrastructure charge for all customers.

CCWater raised a concern about the potential effects that the new charging regime may have on those small-scale and individual developers who do not pay for network reinforcement costs under the current regime. They said that now that these costs have been incorporated into the infrastructure charge, some of these developers may face significant cost increases, depending on water company policies. The HBF said that

> "The proposals do not adequately address the considerable diversity in customer attitude, and approach that exists within the Water and Sewerage Sector".

As stated in our consultation, we judge that 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 (as set out in the general charging principles in our rules), we expect water companies to consider the different types of customer and their interests (whilst ensuring they do not unduly discriminate against any).

Our rules do not require (nor prohibit) water companies from setting a flat infrastructure charge. Indeed, our rules provide much more flexibility for water companies to adjust the infrastructure charge, to reflect the particular circumstances of a development[11].

[11] As noted in our July consultation, in general our new charging rules should not undermine any existing agreement between companies and their customers. This will help ensure that in general customers do not suffer undesirable incidence effects. We expect transitional provisions to be included in the commencement order that Defra will make to bring into force the provisions of the Water Act 2014 that will replace the existing charging provisions in the Water Industry Act 1991 with our charging rules.

3.2 Definition of site specific costs and boundaries

In our view:

- a process led by Water UK and the sector is best placed to refine and improve the collaborative work that has been carried out to date in defining the boundaries between types of charges for water and wastewater services.

We received a number of consultation responses asking for greater transparency on the definition of network reinforcements costs, site specific costs and the boundaries between the different types of charging.

We see there is clear benefit for all stakeholders in clarifying, early in the process, the costs that should be met by developers or self-lay providers and those costs that are to be borne by water companies.

Working with Fair Water Connections and Yorkshire Water, we have been seeking to facilitate a shared understanding of site specific and network reinforcement costs and the boundaries between the different charges.

To date this work produced a working diagram for the water service that shows those existing water company network assets e.g. pumping stations and service reservoirs, that may be subject to network reinforcement in consequence of the new connections. Such costs will be paid for by developers through water companies' infrastructure charges. The diagram also shows those existing water company strategic assets eg water treatment works where, should any reinforcement be necessary, these costs would not be included within the infrastructure charge and would therefore not be paid for by developers.

Based on this work, we developed a similar diagram for the wastewater service. The work also identified the need to develop a definition for the 'Point of connection' between a new development site and the undertaker's existing asset. This definition is important to establish consistency in the boundary between site specific and network reinforcement costs. In addition, if water companies are able to identify and communicate the 'Point of connection' for a new development early in the process, this could help to support competition in contestable services. That is, self-lay providers would be able to provide developers with fixed quotations for services rather than estimates that do not take account of this key information.

As understanding of the new charging arrangements increases, we expect the diagrams will need refinement and improvement. Water UK have agreed to take this work forward as part of its collaborative approach to implementation. Where

appropriate, we will consider refining our rules in light of the agreed outcomes of this work.

4 Next steps

A key benefit of moving to a new system of Ofwat-determined charging rules is that this approach creates additional flexibility – it allows us to amend our rules when appropriate.

Our approach to implementing, monitoring and reviewing our new charging regime is as follows:

- **we will monitor implementation during the additional, transitional year and review industry progress during March 2017** – we can take a view then whether any updates to our rules or further guidance is required in advance of the implementation date of April 2018;
- **we will chair the 'Monitoring and Reporting Working Group'** – our intention is to work up proposals for consultation on regulatory reporting for the 2017-18 reporting year;
- **we will give further consideration to introducing an incentive mechanism at PR19, including options in our methodology consultation for PR19 in June / July 2017** – we will consider the viability of introducing specific mechanisms or reputational incentives for cost reflective infrastructure charging to developers, taking into account the interactions with other tools within our price control methodology; and
- **we will keep the new connections market under review and will review implementation of our charging rules as and when appropriate.**

A1 Consultation questions

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?

A2 List of respondents

A2.1 Water companies

1. Affinity Water
2. Anglian Water
3. Bristol Water
4. Northumbrian Water
5. Portsmouth Water
6. Sutton and East Surrey Water
7. Southern Water
8. South Staffordshire and Cambridge Water
9. Severn Trent Water
10. South West Water
11. Thames Water
12. United Utilities
13. Welsh Water
14. Wessex Water
15. Yorkshire Water

A2.2 New Appointees

1. SSE Water
2. Independent Water Networks
3. Albion Water
4. Icosa Water

A2.3 Other

1. MA infrastructure
2. PDI Utilities
3. CCWater
4. Croudace
5. Energetics Design and Build
6. Fortridge Consulting Limited
7. Fair Water Connections
8. House Builders Association
9. Home Builders Federation

A3 Summary of changes to our proposed rules for new connections

This annex sets out the amendments to our charging rules for new connections. Key changes have been explained in the main body of the document. All other changes are to made for the purposes of clarification, completeness, simplication or drafting improvements, as the case may be.

Figure A3: Alterations to new connections rules (compared to July consultation proposals)

Original rule no.	Alterations to text	Rationale for change
2	These rules have effect in relation to charges imposed on or after 1 April ~~2017~~ 2018 by water undertakers and sewerage undertakers whose areas are wholly or mainly in England.	Alteration of implementation date
5(b)	"**Charging Arrangements"** means a document setting out the charges, Income Offsets and Asset Payments, and/or the methodologies for calculating those, applied by the water or sewerage undertaker in accordance with these rules.	Clarification
New definition	"Connection Charges" has the meaning given by paragraph 31 below.	Clarification
New definition	"Diversion Charges" has the meaning given by paragraph 42 below.	Clarification
5(h)	~~Domestic Premises" means any premises used wholly or partly as a dwelling or intended for such use.~~	Simplication
5(i)	… 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 areas).	Clarification
5(j)	... sewerage services to premises connected~~ion~~ to the new Sewer. …	Drafting
New definition	"Requisition Charges" has the meaning given by paragraph 23 below.	Clarification
5(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. This definition includes tunnels or conduits which serve as such a pipe and any accessories for such a pipe.	Clarification

Original rule no.	Alterations to text	Rationale for change
5(r)	... a requested Water Main, Sewer, Communication Pipe or Lateral Drain on, to or in the immediate vicinity of, the Development …	Clarification
New definition	"**Small Company**" means a New Appointee or Cholderton and District Water Company Limited.	Proportionality
9	… For the avoidance of doubt, the charges and charging methodologies set out in the Charging Arrangements must therefore include any relevant miscellaneous and ancillary costs such as assessment, inspection, design, legal, supervision charges that the undertaker is entitled to recover, unless there is a different legal basis for the recovery of such costs.	Clarification / Completeness
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~~ 2018 onwards.	Alteration of implementation date
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~~.	Consistency

Original rule no.	Alterations to text	Rationale for change
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.~~ These rules apply to a Small Company subject to the following provisions: a) a Small Company is not required to publish one or more of the charges or Asset Payments covered by these rules (or a methodology for calculating them) where it would be unreasonable to expect the company to do so (having had regard to the number of requests for the relevant services that the company would reasonably expect to receive); b) the charges imposed, or Asset Payments made, by a Small Company under the provisions of the Water Industry Act 1991 covered by these rules must be calculated in accordance with the principles and requirements set out in these rules whether or not they are published in Charging Arrangements and this includes, where relevant, requirements to provide the option of upfront Fixed Charges; c) paragraph 9 of these rules does not restrict the maximum amount of a charge imposed by a Small Company if Charging Arrangements published by that company do not include relevant charges or charging methodologies; d) paragraph 10 of these rules does not apply to a Small Company – instead, a Small Company must publish any Charging Arrangements no later than five weeks before the period in relation to which they have effect; and e) for the avoidance of doubt, this paragraph does not exempt a Small Company from the requirement in	Proportionality

Original rule no.	Alterations to text	Rationale for change
	paragraph 45 of these rules to clearly set out in its Charging Arrangements requirements for security in relation to any charges to be applied.	
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 prior to the implementation of these rules 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.	Clarification
20	Consistent principles and approaches must be applied to the calculation of charges and when they are payable for different classes of customer…	Clarification / Completeness
21	Charges (including any Income Offsets), any Asset Payments and arrangements for when they are each payable must be set in accordance with the principle that they should promote effective competition for Contestable Work.	Clarification / Completeness
26	Requisition Charges must relate to ~~physical infrastructure required to provide~~ the costs of providing	Clarification / Completeness

Original rule no.	Alterations to text	Rationale for change
	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: … b) must not relate to work needed or desired to modify or enhance existing network infrastructure in order to address pre-existing deficiencies or enhance network flexibility, in capacity or capability, unrelated to requirements associated with the requisition.	Clarification / Completeness
28	… the costs of this work shall, if this increases the costs of the work, be apportioned …	Clarification
30(a)	… Each undertaker has discretion as to the methodology to be applied to calculate an Income Offset. Such methodology must, however, be clearly explained in the applicable Charging Arrangements; …	Drafting
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 any amount for 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~~.	Drafting
New rule	Any charges imposed by an undertaker in respect of an agreement under section 51A or section 104 of the Water Industry Act 1991: a) must relate only to Site Specific Work carried out and costs incurred by the undertaker in order to meet its duties under such an agreement; and b) must not relate to work needed or desired to modify or enhance existing network infrastructure in order to	Clarification

Original rule no.	Alterations to text	Rationale for change
	address pre-existing deficiencies, in capacity or capability, unrelated to requirements associated with the agreement.	
43	An undertaker is allowed to require security prior to commencing work, whether in the form of a sum deposited with the undertaker or otherwise: …	Clarification
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: … iii. explaining how the present balance of charges between Developers and other customers is broadly maintained.	Drafting / Clarification

A4 Summary of changes to our proposed rules for Charges Scheme rules

This annex sets out the amendments to our charges scheme rules. Key changes have been explained in the main body of the document. All other changes are to be made for the purposes of clarification or completeness.

Figure A4: Alterations to charges scheme rules rules (compared to July consultation proposals)

Original rule no.	Alterations to text	Rationale for change
5	"Network Reinforcement" has the same meaning as in the charging rules for new connection services issued by the Water Services Regulation Authority under sections 51CD, 105ZF and 144ZA of the Water Industry Act 1991; ~~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~~	Drafting consistency
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~~ 2023 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.	Consequential change to due alteration of implementation date

32(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 in the 5 years before the modification or redevelopment began (including supplies of water that were not for domestic purposes and drainage that was not for domestic sewerage purposes) associated with the buildings and/or premises to which the charges are to be applied and be discounted accordingly; and	Clarification/ completeness
33	Rules 26 to 32 above do not apply to: a) new appointees; or b) any charges scheme that has effect in relation to a period ending before 1 April 2018.	Proportionality / consequential change to due alteration of implementation date

A5 How our rules address known issues

Issue	Detail	How our charging rules help to address the issue
Administrative burden	Calculations of charges can be complex. Companies must also carry out a true up to adjust for differences between estimates and actual costs. Ofwat have received a large number of determinations.	Allow water companies to develop their own charging schemes so they are not bound to using complex calculations. Require companies to set out a series of upfront fixed charges. This may reduce the administrative burden from complaints as charges will be better understood by all stakeholders.
Risk of double charging	Perception that companies double charge for network reinforcement in the requisition and infrastructure charge.	Set a single charge to cover off-site network reinforcement triggered by a new development.
Unclear incentives to self-lay that may harm competition	Difficult for developers to compare costs due to the lack of transparency. Self-lay providers are concerned they are at a competitive disadvantage eg Self-lay charges cover different costs across different companies. They are only entitled to asset payments for water assets and not sewerage assets.	Companies to clearly show which charges are associated with on-site and off-site works. In the long run, we may introduce asset payments for wastewater, subject to understanding what the potential impact would be.
A 'first mover disadvantage'	The first development in an area often pays more for network reinforcement than subsequent developments in that area. Also differences between companies in the approach taken to share costs between customers when upstream works serve more than one development.	Companies to set a fixed infrastructure charge for an area. This removes the first mover disadvantage as infrastructure costs are averaged out across developers in that given area.

Issue	Detail	How our charging rules help to address the issue
Arbitrary calculations	Little economic rationale for the calculation of the RD/DADs formula or why asset payments are also only made to self-laid water mains but not sewers.	Companies must prove the balance of costs between developers and customers is broadly maintained. Charges to be developed in consultation with stakeholders. This should reduce the existence of arbitrary calculations as stakeholders should understand the rationale behind charges.
Weak price signals	Infrastructure charges are fixed across companies. There are weak price signals to encourage developers to build in areas where there is existing network capacity, leading to inefficiency.	Companies must consider the role of charging structures that send environmentally beneficial price signals to developers.
Lack of transparency	Developers are unclear what they are paying for as costs are not broken down in their bills. Companies interpret 'recovering reasonable costs' in different ways leading to a lack of trust between companies and stakeholders.	Companies to publish a single document with their charges for new connections. Those charges must be developed in consultation with key stakeholders.
Interactions with planning framework	Developers have raised concerns that companies use the statutory planning framework to make developers fund network reinforcement. The Water Industry Act 1991 does not cover this route but the fact that some companies and undertaking this route indicates a failure of the current framework.	The planning framework is outside of our vires but our charging rules will help address investment ahead of need. So, there may be a reduction in the requirements placed on developers via the planning framework.
Investment ahead of need	Companies are concerned that the current framework does not facilitate investment ahead of need. Companies may be reluctant to invest ahead of need because of distributional issues of who	Companies to be able to charge a fixed average fee for network reinforcement for a given area or type. This gives companies a constant cash flow and potentially helps to enable

Issue	Detail	How our charging rules help to address the issue
	should bear the costs, either developers or bill payers.	investment ahead of need where appropriate.
Predictability of charges	It is hard to predict costs due to the differences between estimates and actual costs and complex formulae.	Companies set out a series of fixed charges and clear methodologies of how charges are calculated. This will provide greater predictability over the charges developers will receive.
Delays	Complex modelling required for offsite network reinforcement can create delays in housebuilding. Delays also increase operating costs beyond their efficient level for developers.	New rules will give companies the flexibility to simplify charging methodologies. This will potentially reduce delays in housebuilding and lower costs for developers which can be passed on to house buyers.