

December 2018

Trust in water

New connections charges for Welsh companies – consultation

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 companies for new connections and other infrastructure services.

Within this legislative framework this document is a consultation on options for setting rules for new connection services for **water companies whose areas are wholly or mainly in Wales**.

We have produced a draft impact assessment on these options which we include as an annex to this consultation document. This assessment aims to highlight and, where possible, quantify the impacts that we anticipate as a result of introducing the options that we consider.

We are seeking the views of all interested parties and welcome responses by 24 **January 2019**.

After considering the responses to this consultation, if appropriate, we will undertake a further consultation in spring 2019 on a finalised set of proposed charging rules.

Contents

1.	Introduction	5
2.	Context and approach	8
3.	Options for charging rules	19
4.	Next steps	28
A1	Option 2 charging rules for new connections	30
A2	Option 2 revised charges scheme rules	43
A3	Draft modification – condition C (infrastructure charges)	51
A4	Draft impact assessment	54

Responding to this consultation

We welcome your responses to this consultation by **24 January 2019**.

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

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

We will publish responses to this consultation on our website at www.ofwat.gov.uk, unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (FoIA), the General Data Protection Regulation 2016, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our [Privacy Policy](#).

If you would like the information that you provide to be treated as confidential, please be aware that, under the FoIA, there is a statutory ‘Code of Practice’ which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

1. Introduction

Water companies¹ whose areas are wholly or mainly in Wales (“Welsh companies”) have a duty to allow new connections to be made to their existing networks, including for new housing developments.

We use the term new connections for when a customer requires either or both:

- access to the existing public water supply or sewerage system by means of a service pipe or lateral drain; or
- a new water main or public sewer.

New connections are contestable services. If a property requires a new water main, sewer, service pipe or lateral drain for domestic purposes (defined at section 218 of the Water Industry Act 1991 (WIA91) as drinking, washing, cooking, central heating and sanitary purposes), the owner or developer may ask the local water company to install the infrastructure. For water mains and public sewers this is often referred to as ‘requisitioning’ the infrastructure. Alternatively, they may choose their own contractor to do the work, known as ‘self-lay’. The water company will take over responsibility for (‘adopt’) all self-laid infrastructure that meets the terms of its agreement with the owner, developer or self-lay provider (SLP) that carried out the work.

The WIA91 provides for water companies to charge for new connections to their network and for associated infrastructure work. The basis for each charges is set out in the WIA91, which means that the rules are not readily adaptable to change.

The Water Act 2014 (WA14) sets out a new framework for the regulation of charging in the water industry. Some parts of this framework are yet to be brought into force for Welsh companies and we will work with the Welsh Government and the Department for Environment, Food and Rural Affairs (Defra) on the timing for commencement. The new framework, including charging for new connections, enables:

- Ofwat to develop charging rules for Welsh companies to replace the charging provisions in the WIA91;

¹ In this document, references to such companies means companies holding appointments as water undertakers and/or sewerage undertakers under the Water Industry Act 1991.

- Welsh Ministers to issue us with charging guidance for new connections, the purpose of which is to enable our charging rules to reflect Welsh Government policy priorities for the water sector; and
- Welsh companies to publish charging arrangements for new connections and associated infrastructure that adhere to the charging rules.

Under the new framework, we can update our rules (subject to appropriate consultation) after they have first 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 and respond to them as necessary.

Complementary to but separate from this, our price control limits the incentive for water companies to levy excessive charges onto developers, as the more revenue water companies recover from developers (in relation to their regulated activities including new connections), the less they are allowed to recover from water customers (and vice versa).

This document is a consultation on options for setting rules for new connection services for Welsh companies.

There are three Welsh companies – Dŵr Cymru Welsh Water, Hafren Dyfrdwy and Albion Eco Limited (Albion Eco). Under our preferred option, we propose that Albion Eco would be affected by a proportionate version of our proposals which is designed to avoid placing an unreasonable administrative burden on small companies.

The three options for Welsh companies on which we are consulting are to:

- maintain the **status quo** of the current charging framework for new connection services;
- introduce a set of **principles-based rules** for new connections services; and
- introduce high-level, **light-touch rules** for new connection services.

The remainder of this document is structured as follows:

- In chapter 2, we set out the context in which we are developing options for new connection charges. This includes the legal basis for setting charging rules as well as the issues with the current charging framework.

- In chapter 3, we set out the options that we have considered as part of our assessment and explain why option 2 is our preferred option.
- In chapter 4, we set out specific questions that we are consulting on and provide an overview of the next steps in the process.
- Annexes A1 to A3 set out illustrative examples of the charging rules and licence modifications that we would look to introduce if we implemented our preferred option, option 2.
- Annex A4 is our draft impact assessment of the options that we have considered.

2. Context and approach

In this chapter we discuss the context and background to our approach to developing new connection charging rules for Welsh companies. The legislation, guidance and policy discussed in this chapter relates to Welsh companies unless explicitly stated otherwise.

This chapter discusses:

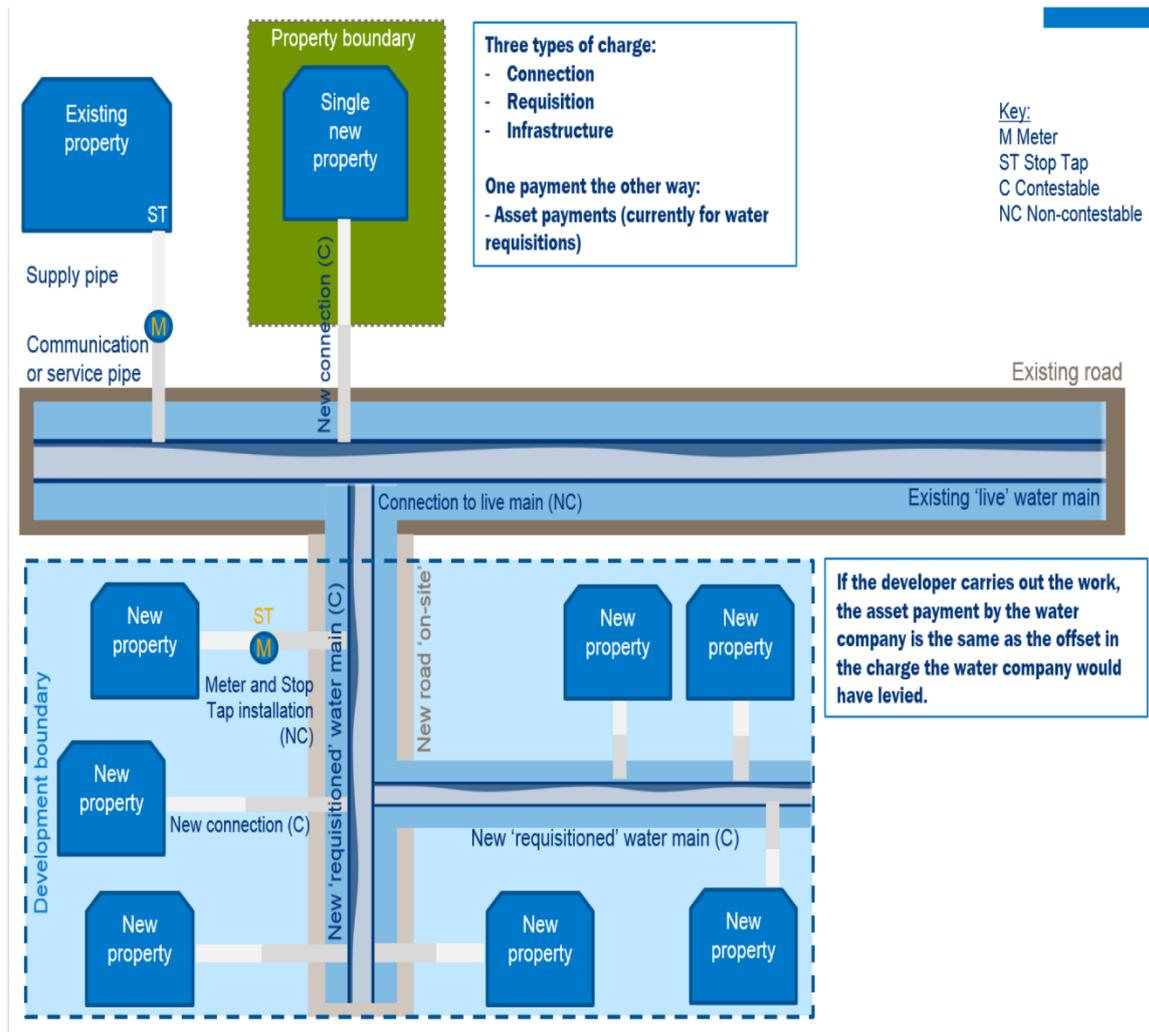
- the current charging framework for new connections;
- Issues with the current framework;
- the new charging framework for new connections;
- the Welsh Government's guidance;
- the development of our approach; and
- interactions with other areas.

2.1. Current charging framework for new connections

The current charging regime for Welsh companies

Figure 2.1 shows diagrammatically the current categories of charges that are affected by this consultation, namely new connection charges, requisition charges, infrastructure charges and asset payments. These charges are listed and described in box 2.2.

Figure 2.1 – New infrastructure and associated charges



Box 2.1 – Current new connection charges levied by Welsh companies

Connection charges are paid by the developer to the water company. The Welsh company sets this charge after the service is provided to recover the costs of the physical connection of the premises to water mains or public sewers.

Infrastructure charges are paid by the developer to the water company when a property is connected to the company’s water supply or sewers for the first time. They contribute to wider network reinforcement to meet the increased demand arising from the new connections. At present, for Welsh companies, they are a fixed charge per property that was set at the same level for England and Wales in 1995 and is adjusted for inflation annually. Standard domestic dwellings are charged a single rate for each service (water and wastewater) and other types of

premises, such as flats which have common billing arrangements, are charged a multiple based upon the number of fittings in the premises.

Requisition charges are paid by the developer to the Welsh company. The Welsh company sets these charges after the provision of the new water main or public sewer (a requisition) to recover the costs reasonably incurred in providing them. As a result, developers enter into agreements for a requisition based on the Welsh company's estimated costs, which may differ significantly from the actual costs upon which the final requisition charge is based. An **income offset** is deducted from the requisition charge, which is calculated either by reference to the relevant deficit (under section 43 of the WIA91) or the discounted aggregate deficit (under section 43A of the WIA91), to reflect the future income the Welsh company should receive from the provision of services to the new development over 12 years. Under the current framework, the requisition charges include the cost of network reinforcement triggered by the development that are not covered by the infrastructure charge.

Self-lay charges. The self-lay option allows the developer to either provide the necessary infrastructure itself or contract with a third party, referred to as a self-lay provider (SLP), to provide it. The developer pays the SLP the cost of providing the self-laid assets. The water company then adopts these assets and, in relation to water mains only, may pay the person with whom it entered the adoption agreement (i.e. the developer or SLP) an asset payment when it takes ownership. As with requisitioning, either the developer or the SLP pay the water company for any additional network capacity required to supply the new development.

New appointees and variations (NAVs). Developers have the option of requesting that a NAV serves a new development site for water and/or wastewater services rather than the monopoly water company in that area. Under this option, a company may apply to Ofwat for a new licence or a NAV may apply to Ofwat for a variation to its existing licence which allows it to become the water and/or wastewater provider for that development. The developer can then make an agreement with the NAV to provide the new water and/or wastewater infrastructure to serve the development site. This allows for competition between NAVs and the incumbent Welsh company to provide developer services to these sites.

The current legal framework for Welsh companies

The WIA91 currently sets out provisions for charging for developer services by Welsh companies (references in this document to sections of the WIA91 are references to those as they apply to Welsh companies unless otherwise specified). These cover:

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

Provisions relating to charges for new service pipe connections for domestic purposes are set out at section 45 of the WIA91 with provisions relating to ancillary works for the purpose of making domestic connection set out at section 46.

Provisions about charging for water main requisitions are set out at sections 42, 43 and 43A of the WIA91. Section 42 enables water companies to charge developers a security deposit. Sections 43 and 43A of the WIA91 set out the two methodologies (the relevant deficit and the discounted aggregate deficit respectively) for calculating the actual requisition charge. These charges are calculated by reference to:

- i. the annual borrowing costs of a loan of an amount that would be required to cover the costs reasonably incurred in providing the main; and
- ii. the revenue which will be recovered by the water company by means of the new main (i.e. the bills paid by customers connected to that main, which is in turn derived from the occupancy rates of the premises connecting) over each of the 12 years following the provision of the water main. This sum is referred to as the 'income offset'.

The WIA91 has sections dealing with charging for the requisition of public sewers and lateral drains at sections 99, 100 and 100A of the WIA91. These provisions are broadly the same as those dealing with charging for main requisitions detailed above.

Provisions regarding charging for communications with public sewers, where the water company intends to make the communication itself, are set out in section 107 of the WIA91.

Provision about charging for moving existing pipes is set out in section 185 of the WIA91.

As well as recovering any costs incurred in providing these services, the water company 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’ and are included in relevant companies’ charges schemes made under section 143 of the WIA91.

Currently, the maximum value of infrastructure charges is set out in Welsh companies’ licences and was set at £200 for water and £200 for sewerage for each new property in 1995 and adjusted annually by the retail prices index (RPI). In 2018-19 the maximum charge was £379 for water and £379 for sewerage.

There are also specific requirements for how Welsh companies can apply the infrastructure charge, such as credits to ensure the infrastructure charge only applies to properties above the number previously connected on the site in the five years before the development started. This reflects the fact that if the network is already tailored to cater for the demand for these properties, the water company is not expected to incur incremental costs.

Welsh companies’ licences also set out a relevant multiplier formula which weights the infrastructure charge by the number of water fittings in a property. This is a proxy for the property’s expected consumption, and applies to properties with common billing agreements (such as flats) or where the service pipe is greater than the standard size.

2.2. Issues with the current framework

Previous independent reviews of the water sector raised concerns over the existing developer services charging framework. The independent review of competition and innovation in water markets (the [Cave review](#)) recommended reform to ensure developers and water companies pay their fair share of necessary network reinforcement, and that water companies should produce transparent prices and methodologies for the calculation of charges. The review of Ofwat and consumer representation in the water sector (the [Gray review](#)) noted concerns from developers about transparency and consistency.

We have identified a number of shortcomings with the existing framework which are outlined in table 2.3 below. These are based on evidence we have collected through our dispute resolution cases for developer services in England and Wales.

Additional evidence was gathered through our earlier broad-based stakeholder engagement on issues relating to the previous charging regime. These were issues with the charging regime that was in place for both Welsh and English² companies at the time and which is still in place for Welsh companies. We have previously used this evidence to inform our development of the new connections charging rules for English companies, as set out in our March 2016 discussion document. As the issues are concerned with the charging regime in general rather than issues specific to Welsh or English companies, we consider that this evidence is equally applicable to our consideration of charging rules for Welsh companies.

Table 2.3 – Issues with the current framework for Welsh companies

Issues	Detail
Administrative burden	The current charging framework for Welsh companies is administratively cumbersome as Welsh companies currently provide an upfront calculation on the estimated contestable charges and following completion of the work they undertake a reconciliation for the actual costs. Ofwat has been involved in a significant number of determinations over disputes regarding the reconciliation of estimated and actual costs.
Predictability of charges	The uncertainty and lack of transparency about how water companies calculate charges can often result in differences between estimated and actual costs which the water company charges to the developer. This lack of predictability in charges is an issue for developers in their decision making on developments.
Risk of double charging	Developers have told us that due to a lack of transparency in how water companies calculate charges, there is a perception that they charge twice for network reinforcement, through both the requisition charge and the infrastructure charge.
A ‘first mover disadvantage’	The first development in an area often pays more for network reinforcement than subsequent developments in that area. There are also inconsistent approaches to sharing costs between developers when upstream work serves more than one development.
Arbitrary calculations	There is little economic rationale for the calculation of the income offset, or why asset payments are not applied to sewerage assets.
Weak economic price signals	At present, infrastructure charges are fixed at the same level for all Welsh companies and do not reflect the costs incurred in carrying out the reinforcement works that they are supposed to fund. This leads to weak price

² In this document, ‘English companies’ refers to companies whose areas are wholly or mainly in England.

	signals to encourage developers to build in areas where there is existing network capacity, contributing to inefficiency.
Lack of transparency	Developers are unclear what they pay for as costs are not broken down in bills.
Interactions with the planning framework	Developers said some water companies use the statutory planning framework to make developers fund network reinforcement. This represents a failure of the current framework as this is not covered in the WIA91.
Efficient network planning	Water companies have told us that the current framework does not facilitate efficient network capacity investment planning as they do not have sight over a long enough period of upcoming developments. Water companies also cited some reluctance to undertake investment planning over a long time horizon because of distributional concerns over who should bear the costs – developers or other customers.
Unclear incentives to self-lay that may not provide a level playing field	Currently, it is difficult for developers to compare costs of contestable services as water companies do not always set out their charging arrangements up front and in a clear way including explaining how the charges have been calculated.
Delays in developments	Complex modelling required for offsite network reinforcement can create delays to housebuilding. Delays increase operating costs for developers above their efficient level.

2.3. New charging framework for new connections

New legislative framework

Changes to the WIA91 brought about by the WA14 will remove many of the rules in the WIA91 relating to charging for developer services and instead require the Welsh Government to issue us with charging guidance and, having regard to that guidance, allows us to set rules about these charges. Welsh companies will then have to set their final charges in a way that complies with the rules and their other legal obligations. This chapter sets out the new legislative framework, which will require the Welsh Government and Defra to commence certain sections of the WA14 to take effect.

Section 144ZA of the WIA91 allows us – in accordance with the relevant sections of the WIA91 – to set rules about the contestable 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 diversion or alteration of pipes and other infrastructure.

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

As detailed above, infrastructure charges are included in relevant water companies' charges schemes made under section 143 of the WIA91. Section 143B of the WIA91 allows us to set rules about charges schemes, including infrastructure charges. Our charging rules can make provisions about the:

- types of charges that may be imposed;
- amount or maximum amount, or the methods for determining the amount or maximum amount, of any type of charge;
- principles for determining what types of charges may or may not be imposed;
- principles for determining the amount of any charge that may be imposed;
- timing of payment of charges; and
- publication of charges or charges schemes.

Rules might also provide for the reduction of charges under a charges scheme made under section 143 of the WIA91 where conditions specified by the rules are satisfied.

These rules will cover the charges made to developers by Welsh companies in relation to new connections to both household and non-household premises, but only where the connections are for domestic purposes.

The rules will therefore **not** cover:

- water companies whose areas are wholly or mainly in England (English companies);
- 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; or
- charges made to other water companies or sewerage companies (including new appointees) to provide a bulk supply of water or bulk discharge services.

Wales Act 2017

Under current legislation, the Welsh Government has jurisdiction over the activities of water companies whose areas are wholly or mainly in Wales. We have developed our proposals (including the proposed charging rules) set out in this consultation to reflect this. In the future, as facilitated by the Wales Act 2017, we expect the

jurisdiction of Welsh and UK governments, in relation to water and wastewater, to be more aligned with national boundaries rather than companies' boundaries. Whilst our proposals are based on companies' boundaries, we will consider if any changes to our charging rules are required at the time relevant parts of the Wales Act 2017 are brought into force.

2.4. Welsh Government guidance

In developing our charging rules for Welsh companies, we are required to have regard to the Welsh Government's relevant charging guidance to us.

The Welsh Government issued [charging guidance](#) to us in 2016 and [further guidance to us relating to new connections charges](#) in February 2018 which we are required to have regard to when making charging rules. In January 2018 the Welsh Government published its [strategic priorities and objectives statement](#), which we must act in accordance with.

The Welsh Government's guidance on charging rules for new connections said that charging arrangements should be set in accordance with the following principles:

- simplicity and transparency;
- stability, predictability and timeliness;
- fairness and cost reflectivity; and
- environmental sustainability.

The guidance said that Welsh companies' charging arrangements should promote effective, timely and proportionate consultation, to help ensure local circumstances within each appointment area are taken into account.

The guidance asks Ofwat to encourage Welsh companies to engage with all relevant stakeholders including the Consumer Council for Water (CCWater) and developers. This is underlined by an expectation that Ofwat will encourage Welsh companies to publish a statement setting out the engagement undertaken, how they have taken the views of stakeholders into account and setting out and justifying where there is a trade-off between the principles set out by the Welsh Government and any competing priorities and objectives raised by stakeholders. In addition, the guidance said we should consider and consult on:

- whether there are different implications for single-build and multiple-build applications and whether our charging rules should apply differently;

- a rule to require non-site specific charges (infrastructure charges) to broadly equal costs over a set period;
- any transitional arrangements that may be required; and
- how the charging rules can promote the use of sustainable drainage systems (SuDS).

In developing our proposed options for charging rules for new connections we have had regard to all relevant guidance to us from the Welsh Government, reflecting the principles set out and specific issues raised.

2.5. The development of our approach

We published our March 2016 emerging thinking document on charging for new connections based on extensive stakeholder engagement and feedback. We discussed issues which stakeholders had raised with us about the existing framework which applied to both England and Wales. At the time, we said the development of charging rules for Wales would rely on future guidance from the Welsh Government.

We have since engaged further on new connections charging rules for Welsh companies. In particular we engaged in a series of meetings with key Welsh stakeholders in early 2018. We also issued an informal information request to two large Welsh companies, a developer representative body and a NAV to identify issues with the current framework and to gather information about the likely costs of implementing new charging rules for the Welsh companies.

New connection charging rules for English companies

Following changes to the legal framework by the WA14 which enabled Ofwat to set charging rules, we consulted on our emerging thinking on charging for new connections (in our [March 2016 emerging thinking document](#)). Following this we consulted on new connections charging rules for English companies in July 2016, with our new rules published later that year (in our [December 2016 decision document](#)). We later consulted on a proposal regarding how we would treat the income offset for new connections services for English companies from April 2020 (the results of this consultation can be found in our [November 2017 decision document](#)).

2.6. Interaction with other areas

Charging rules are one element of the overall regulatory framework that applies to new connection services.

Reporting requirements

We are introducing additional reporting requirements to monitor water companies' performance to compare as far as reasonably practicable the revenue collected through infrastructure charges and costs over a rolling five year period. These changes have been incorporated into water companies' Annual Performance Reports from 2018-19, including Welsh companies.

This change forms part of the Regulatory Accounting Guidance (RAG) for 2018-19, where water companies will need to report on all infrastructure network reinforcement costs. The second change, which will form part of the RAG for 2019-20, will include a requirement for water companies to explain any variation between revenue collected through the infrastructure charge and actual costs incurred. This will highlight where companies have not offered cost reflective infrastructure charges to developers.

Price controls

The price control limits the incentive for water companies to levy excessive charges onto developers, as the more revenue water companies recover from developers (in relation to their regulated activities including new connections), the less they are allowed to recover from water customers (and vice versa). The current price review (PR19) will set limits to the revenue that Welsh companies can recover from their customers for the 2020-25 period.

3. Options for charging rules

This chapter consists of:

- our objectives for assessing charging options;
- options for charging rules we have considered to address the issues that have been identified;
- our assessment of these options against the status quo; and
- how the options align with the Welsh Government’s guidance.

3.1 Our objectives for new connection charges

Our vision for the water sector in Wales and England is one where customers and wider society have trust and confidence in the vital public water and wastewater services.

To support our strategic vision, our aim is to establish a new connections charging framework with the following objectives:

- increase **predictability**, notably through water companies fixing charges prior to the work being carried out;
- increase **transparency** of charging publications, engagement between companies and stakeholders before publication, and clarity over which charges are expect to recover what costs;
- place the **ownership / accountability** with companies to develop charging approaches. This should enable greater flexibility for more straightforward approaches and fewer arbitrary calculations;
- support **cost-reflective and fair charges**, including no undue preference in the fixing of charges;
- support **environmental sustainability**. Charges provide an opportunity to improve the environmental outcomes by reflecting their value in the charging arrangements; and
- reduce the **administrative burden**, across stakeholders, in the preparation and application of charges and in disputes.

These have been prepared by adapting the objectives we have used for developing the framework for new connection charges for English water companies to have regard to Welsh Government guidance. In this chapter we also assess options with respect to the Welsh Government’s guidance to us. Our draft impact assessment is set out in annex A4.

3.2 Description of options

On the basis of the issues identified with current new connection charges, as set out in chapter 2, we have identified three options: the status quo, principle-based rules and light touch rules. Our assumption is that each option would be implemented in April 2020.

Option 1 – status quo

Under this option we would not propose to modify the current new connections charging framework for Welsh companies³.

Option 2 – principles-based rules

Under this option we would introduce a set of principles-based rules for new connection services for Welsh companies. This approach would be similar to the approach that we have taken when introducing rules for other charges as a result of the changes made by the WA14. This includes:

- our [charges scheme rules](#) that related to charges to household customers in Wales and England, and infrastructure charges for English companies; and
- the development of [charging rules for new connection services](#) that apply to English companies.

As a more flexible approach, we would be able to actively respond to the Welsh Government's guidance, and regulatory best practice, learning from the current arrangements and stakeholders' views.

As well as issuing rules, we would largely remove licence condition C as it currently sets out rules relating to the amount that can be charged through infrastructure charges. The rules covering infrastructure charges would then be included in our charges scheme rules which would allow flexibility to amend them without the need to amend a company's licence.

We propose to include a transitional arrangement that would allow the option for agreements that were in place before any changes to the charging framework came

³ If the Welsh Government and Defra commence the relevant parts of the WA14 that require Welsh companies to charge by reference to charging rules, under this option we would issue charging rules that match the current charging arrangement for Welsh companies.

into effect to continue as they were. This would be to ensure that this change would not adversely impact any existing agreements. We would work with the Welsh Government to ensure that the commencement of the relevant parts of the WA14 necessary for us to introduce new connection charging rules would allow for this transitional process.

We have set out proposed charging rules for new connections and an amended version of the charges scheme rules in full in annexes A1 and A2. Box 3.1 below summarises the key provisions for the proposed charging rules.

The proposed charging rules for new connection services are similar to those that are currently in effect for English companies. The proposed rules differ from those in place for English companies due to differences between the charging guidance issued by the Welsh Government and Defra. The proposed rules for Welsh companies include a requirement to consider options for promoting the use of SuDS. They include a requirement to explain how they have taken the views of stakeholders into account when making their charging arrangement, and set out and justify where there is a trade-off between the general charging principles and objectives raised by stakeholders.

In order to assist stakeholders in identifying the differences between the proposed rules for Welsh companies and the rules in place for English companies, we have highlighted the differences between the two sets of rules in red text in annexes A1 and A2.

Box 3.1 – Summary of our proposed charging rules under option 2

Under our charging rules, Welsh companies would be required to:

- ensure charges reflect the principles set out by the Welsh Government of simplicity and transparency; stability, predictability and timeliness; fairness and cost reflectivity; and environmental sustainability;
- ensure the balance of charges between developers and bill payers is broadly maintained, unless justification is provided;
- allow a level playing field for contestable work between new appointees, self-lay providers and existing undertakers;
- set requisition charges and connection charges for most developer services as upfront fixed charges in-line with the Welsh Government’s guidance that charges should be predictable, but they may set out alternatives in their charging arrangements in addition to these fixed charges and explain the reason for doing so;
- consider how their charges incentivise the building and adoption of SuDS; and

- define requisition charges to be site specific (excluding any network reinforcement costs).

When setting infrastructure charges, Welsh companies would be required to:

- ensure they reflect the principles of simplicity and transparency; stability, predictability and timeliness; fairness and cost reflectivity; and environmental sustainability;
- ensure infrastructure charges reflect the cost of network reinforcement over a rolling five year period and do not cover the cost of providing additional network capacity, for example at wastewater and water treatment works to ensure there is no overlap between the costs that different charges ought to cover;
- include a clear methodology in their charging arrangements for how the infrastructure charge has been derived;
- consider setting infrastructure charges as a fixed charge, or calculated with a formula that is cost reflective of different decisions – including variations to promote environmental sustainability and water efficiency; and
- take account of previous connections, explaining the methodology behind any discounts or credits.

When considering the income offset:

- It should be netted off the requisition charge;
- Welsh companies would have discretion on how they calculate the income offset as required by the Welsh Government's guidance. The infrastructure charge should be cost reflective, but if this leads to an increase in the infrastructure charge, consideration should be given to increasing the income offset to ensure that the current balance of charges is maintained. Welsh companies would be required to clearly explain their methodology in their charging arrangements; and
- The methodology for calculating income offsets must be equivalent to asset payments calculations.

To promote transparency to customers, Welsh companies would be required to:

- Consider a range of options for their charging structure and consult on their charging arrangements with relevant stakeholders, in particular customers and CCWater;
- Publish a statement setting out the engagement undertaken with stakeholders and how they have taken their views into account in developing their charging arrangements, including any trade-off made between the principles set out by

the Welsh Government and any competing priorities and objectives raised by stakeholders;

- Publish their charging arrangements at least two months before they apply (to be proportionate, publishing charging arrangements is optional for NAVs, but they must still comply with our rules); and
- Ensure their charging arrangements cover all relevant costs and explain the calculations and methodologies for how the charges were derived so that their customers can understand them, in-keeping with the Welsh Government's principle that the charges should be transparent and simple.

Option 3 – light-touch rules

Under option 3, the rules would be much shorter than option 2. For site-specific services we would issue light-touch rules. These would primarily consist of principles, reflecting Welsh Government's guidance and our statutory duties.

As with option 2, charges for non-site specific services would take the form of an infrastructure charge.

Welsh companies would 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 should reflect:

- (a) simplicity and transparency;
- (b) stability, predictability and timeliness;
- (c) fairness and cost reflectivity; and
- (d) environmental sustainability.

In addition to this Welsh companies would be required to develop their charging arrangements with reference to the following:

- i. water companies should undertake effective, timely and proportionate consultation in their proposed charging arrangements before such arrangements are set;
- ii. charging arrangements must be published in a clear and accessible format, sufficiently in advance of the charging arrangements coming into effect; and
- iii. in setting charges water companies should take reasonable steps to ensure that the present balance of charges between developers and bill payers prior to the implementation of these rules is broadly maintained unless rendered necessary by circumstances and with the provision of a clear objective justification for doing so.

As with option 2, we would introduce rules for the calculation of infrastructure charges. The existing licence condition C would be amended to remove rules relating to the amount that can be charged through infrastructure charges.

As with all these options, the charges would be subject to the PR19 revenue cap, so Welsh companies would not benefit financially from overcharging. We would propose to introduce these rules in April 2020.

3.3 Our assessment

We have set out our draft impact assessment of the three options in annex A4. In this section we provide a high level summary of the conclusions of the assessment, together with an assessment with respect to our objectives for the charging framework.

Based on our analysis, option 2 is our preferred option. We consider it will deliver the following benefits and potential disbenefits relative to the status quo:

- encouraging **transparency and predictability** – by requiring advanced publication of fixed charges;
- Supporting companies' **ownership and accountability** of their charges, as supported by the new legislation, by giving them flexibility to set their charging arrangements subject to our rules, and to give us assurance that they are complying with our rules;
- encouraging **innovation** and **environmental sustainability** – our rules encourage the use of charging structures to promote SuDS where appropriate and give companies the flexibility to design charges to promote water efficiency;
- reducing the **administrative burden** – developers, Welsh companies and Ofwat will face a lower regulatory burden due to fewer disagreements and higher

predictability and transparency; while there will be implementation costs, these are small in comparison to the ongoing cost savings we expect to be realised; and

- **enabling a level playing field** – rules that allow SLPs or NAVs to compete on an equal playing field with incumbent water companies.

We consider that option 3 will be less effective at achieving our objectives, and would also have larger ongoing costs associated with enforcement. Under this option, we would not set specific rules to address known issues. The high level nature of the rules would tend to mean that charges would be less transparent, and more difficult to compare, than under option 2. We would have to largely depend on casework and ex-post interventions to uphold rules, but, because the high level nature of the rules, enforcement would be more protracted and complex.

3.4 Aligning with the Welsh Government’s guidance

When developing our proposed charging rules under option 2 we have acted in accordance with the Welsh Government’s strategic priorities and objectives statement, and have had regard to guidance issued to us in relation to new connections charges. This section sets out how we have done this.

Strategic priorities and objectives statement

We give an overview of how our preferred option for charging rules aligns with the [Welsh Government’s priorities](#) below.

- **Affordability** – our proposed rules require Welsh companies’ charging arrangements to be in accordance with the principle of fairness and cost reflectivity. To ensure further customer protection, Welsh companies must take reasonable steps to broadly maintain the balance of charges between developers and bill payers which will help to ensure that the introduction of new charging rules does not result in a sudden change in the levels of charges.
- **Innovation** – a more flexible charging framework allows Welsh companies to innovate with their new connections charges, for example to encourage greater water efficiency and more SuDS.
- **Long-term** – by changing the infrastructure charge to be set by each Welsh company to be on a cost reflective year averaged over a fixed period, Welsh companies will have a greater opportunity to invest ahead of need, considering future challenges and long-term requirements on water and wastewater infrastructure.

- **Markets and competition** – our proposed rules better support a level playing field between new entrants and incumbent Welsh companies in the delivery of contestable developer services. Companies are required to publish fixed upfront contestable service charges and consult and engage with local communities and all relevant stakeholders on these charges in order to ensure accountability and legitimacy in their charging arrangements.
- **Resilience** – a more flexible charging framework and better price signals should encourage a more efficient use of resources. Resilience of supply could be improved, for example if Welsh companies use the charging framework to incentivise greater water efficiency and more SuDS.
- **Strong customer focus** – our proposed charging rules require Welsh companies to consult on their charging arrangements with local communities and all relevant stakeholders. We also require Welsh companies to publish their charging arrangements in a clear and accessible format that customers can understand.
- **Sustainable management of natural resources** – a more flexible charging framework enables Welsh companies to incorporate innovative solutions to sustainable development, though we recognise that more significant outcomes may be reached through other means. Our rules also enable more efficient price signals to better reflect the wider environmental costs of new developments.

Welsh Government guidance on new connections charges

The Welsh Government issued guidance to us under section 144ZE of the WIA91 on new connections charges in February 2018.

Our proposed rules under option 2 would require Welsh companies to set charges in accordance with the Welsh Government's high-level principles set out in their guidance. We consider that our proposed rules will deliver these principles in the following specific ways:

- **Simplicity and transparency** – under our proposed rules Welsh companies would have to consult on their charging arrangements before publishing them. Our proposed rules ensure there is a clear boundary between site-specific and other work, and give companies the flexibility to calculate the income offset provided the methodology is clearly published.
- **Stability, predictability and timeliness** – our proposed rules would ensure developers are able to plan with confidence, by requiring Welsh companies to consult on and publish their charging arrangements in advance.
- **Fairness and cost reflectivity** – our proposed rules would require Welsh companies to differentiate between site-specific and non-site-specific work and prevent them from recovering costs for wider network reinforcement to address pre-existing shortfalls. To protect end customers, Welsh companies would be

required to broadly maintain the balance of charges between developers and bill payers. Where there are trade-offs, Welsh companies are required to consult and provide a clear rationale.

- **Environmental sustainability** – our proposed rules will deliver better price signals which should incentivise developments where there is a lower impact on the environment, and also permit Welsh companies to develop more environmentally friendly solutions such as SuDS. However we recognise that the Welsh Government may be able to further promote SuDS through other means such as schedule 3 of the Flood and Water Management Act 2010.

Welsh companies would also be required to act in accordance with the principle that changes to their charging arrangements should only be made after effective, timely and proportionate consultation. To complement this our rules would require Welsh companies to publish a statement setting out any engagement undertaken and how stakeholders' views have been taken into account when developing their charging arrangements.

4 Next steps

We welcome responses to this consultation by **24 January 2019**. We welcome feedback to the questions below.

Questions

Q1 Do you agree with our preferred option, option 2, for Welsh new connections charging rules?

Q2 to Q4 are questions on which the Welsh Government has specifically requested that we consult.

Q2 Do you have any views on whether Welsh companies' charging arrangements should apply differently to single-build and multiple-build applications?

Q3 Are transitional arrangements necessary and if so what should apply?

Q4 Are there additional ways in which our charging rules could reasonably promote the use of SuDS?

Q5 Does the preferred approach place an undue regulatory burden on Albion Eco? If so, what approach would maintain customer protections while avoiding an excessive regulatory burden?

Q6 Are there additional issues, not identified in this consultation, that relate specifically to Welsh companies, which we should take into account when developing new connection charging rules?

Q7 Do you have any comments on the drafting of our proposed new connections charging rules, proposed changes to the charges scheme rules or proposed licence modification?

Q8 Do you have comments on our draft impact assessment? Can you provide quantitative figures in terms of the potential benefits or costs?

Implementation

After this consultation closes we will publish a decision document setting out in more detail if and how we will implement the new charging framework for new connections

for Welsh companies. If appropriate, we will follow this with a consultation on a new connection charging rules. Our intention is that this would give Welsh companies time to develop their charging arrangements for new connections services and effectively consult with stakeholders and customers on them ahead of when the rules would come into effect in April 2020.

A1 Option 2 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 (Welsh Undertakers)

[Differences from the current Charging Rules for New Connection Services (English Undertakers) are shown in red.]

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 2020 by water undertakers and sewerage undertakers whose areas are wholly or mainly in **Wales**.
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) 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
 - e) 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, and/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) “**Connection Charges**” has the meaning given by paragraph 31 below.
- f) “**Contestable Work**” means work or services that either the relevant undertaker or persons other than the relevant undertaker may do or provide.
- g) “**Developer**” means any person or business which is responsible for a Development.
- h) “**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.
- i) “**Diversion Charges**” has the meaning given by paragraph 42 below.
- j) “**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 areas).

- k) “**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.

- l) “**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.
- m) “**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 an agreement with, or a duty owed under the Water Industry Act 1991 to, a person other than a relevant undertaker, including a requisition (under sections 41(1), 98(1) or 98(1A)), under an agreement for adoption (under sections 51A or 104), under a section 66D agreement, 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 Water Main or Sewer.

- n) **“New Appointee”** means
 - i. 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; **or**
 - ii. **Albion Eco Limited.**
- o) **“Non-contestable Work”** means work or services that only the relevant undertaker (or an agent acting on their behalf) can do or provide.
- p) **“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.
- q) **“Requisition Charges”** has the meaning given by paragraph 23 below.
- r) **“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
- s) **“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.
- t) **“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, to, 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.
- u) **“Sustainable Drainage System”** means a drainage system that complies with the national standards for sustainable drainage and those terms shall have the same meaning as in Schedule 3 to the Flood and Water Management Act 2010.

- v) “**Undertaker**” means a water undertaker or sewerage undertaker.
 - w) “**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 effective, timely and proportionate consultation with groups of persons likely to be significantly affected by the proposed Charging Arrangements (or their representatives), **the Consumer Council for Water** 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 2020 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.
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. These rules apply to **New Appointees** subject to the following provisions:
 - a) a **New Appointee** 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 **New Appointee** 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 **New Appointee** 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 **New Appointee** – instead, a **New Appointee** 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 **New Appointee** from the requirement in paragraph 46 of these rules to clearly set out in its Charging Arrangements requirements for security in relation to any charges to be applied.

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) **simplicity and transparency;**
- (b) **stability, predictability and timeliness;**
- (c) **fairness and cost reflectivity; and**
- (d) **environmental sustainability.**

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 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.
- 20. Charges (including any Income Offsets) and any Asset Payments and arrangements for when they are each payable must be set in accordance with the principle that they should promote **a level playing field** for Contestable Work.

21. 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.
22. When setting its charges, Undertakers should consider options for promoting the use of Sustainable Drainage Systems.

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 the costs of providing the requisitioned Water Main and/or Public Sewer. Such charges may not include any amount for Network Reinforcement costs.
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 or to enhance network flexibility, 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, if this increases the costs of the work, 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 an 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 any amount for Network Reinforcement costs.
37. 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 address pre-existing deficiencies, in capacity or capability, unrelated to requirements associated with the agreement.

38. 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.
39. Insofar as section 104 agreements are concerned, sewerage undertakers may provide for Asset Payments for the adoption of a Sewer.
40. 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.
41. 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

42. 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 (“**Diversions Charges**”). In relation to Diversions 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.
43. 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

44. An Undertaker is allowed to require security prior to commencing work, whether in the form of a sum deposit with the Undertaker 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.
45. 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.
46. The Undertaker must clearly set out requirements for security in relation to any charges to be applied in its Charging Arrangements.

Exception from requirements to provide upfront Fixed Charges

47. Undertakers are not required to provide for the option of upfront Fixed Charges in accordance with paragraphs 25 (in relation to Requisition Charges) of these rules, or to comply with paragraph 14, where, and to the extent that, it would be unreasonable to expect an undertaker to do so (having had regard to the practicality of setting a cost-reflective upfront Fixed Charge and the benefit to customers of producing such a charge).
48. Where paragraph 47 applies, an Undertaker must set out, and explain clearly, in its Charging Arrangements the alternative method or methods that will apply for calculating charges.

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 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. explaining how the present balance of charges between Developers and other customers is broadly maintained; and
- iv. explaining how they have taken the views of stakeholders into account when making their Charging Arrangement, and set out and justify where there is a trade-off between the general charging principles and objectives raised by stakeholders.

A2 Option 2 revised charges scheme rules

[Differences from the current Charges Scheme Rules are shown in red.]

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] replace the rules that came into effect on [insert date].
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;
 - “**English Undertaker**” means an undertaker whose area is wholly or mainly in England;
 - “**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:

$$\text{Charge per unit of effluent} = R + [(V + Bv) \text{ or } M] + B(Ot/Os) + S(St/Ss) \text{ } ^7$$

where:

R = reception and conveyance charge [p/m³]

V = primary treatment (volumetric) charge [p/m³]

Bv = additional volume charge if there is biological treatment [p/m³]
M = treatment and disposal charge where effluent goes to sea outfall [p/m³]
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”** has the same meaning
 - i. as in the charging rules for new connection services (English Undertakers) for relevant English Undertakers; and
 - ii. as in the charging rules for new connection services (Welsh Undertakers) for relevant Welsh Undertakersissued by the Water Services Regulation Authority under sections 51CD, 105ZF and 144ZA of the Water Industry Act 1991;
- **“new appointee”** means
 - i. 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; or
 - ii. **Albion Eco Limited**
- **“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;
- **“unmetered charge”** means a charge for services that are not based on measured quantities of volume to any extent; and
- **“Welsh Undertaker”** means an undertaker whose area is wholly or mainly in Wales.

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

26. Each relevant undertaker must fix Infrastructure Charges in a charges scheme.

27. Infrastructure Charges must be determined in accordance with the principle that the charges should reflect:

- i. for each relevant undertaker whose area is wholly or mainly in England
 - (a) fairness and affordability;
 - (b) environmental protection;
 - (c) stability and predictability; and
 - (d) transparency and customer-focused service
- ii. for each relevant undertaker whose area is wholly or mainly in Wales

- (a) simplicity and transparency;
- (b) stability, predictability and timeliness;
- (c) fairness and cost reflectivity; and
- (d) environmental sustainability.

28. Infrastructure Charges must be determined in accordance with the principle that:

- (a) **For English Undertakers** the amount of such charges will over each period of five consecutive Charging Years ending on 31 March 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; **or**
- (b) **For Welsh Undertakers** the amount of such charges will be over each period of five consecutive Charging Years ending on 31 March 2025 and, thereafter, on 31 March in each subsequent year cover the costs of Network Reinforcement that the relevant undertaker reasonable 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:

- a) to the provision of a new water main or public sewer pursuant to an agreement with, or a duty owed under the Water Industry Act 1991 to, a person other than a relevant undertaker (including, but not limited to, the provision of a new water main or public sewer pursuant to a requisition under sections 41(1) or 98(1), a section 66D agreement or, **for English Undertakers only** a section 117E agreement);
- b) to the adoption of infrastructure under a section 51A or 104 agreement; or
- c) 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.

33. Rules 26 to 32 above do not apply to:

- a) new appointees; or
- b) **for English Undertakers** any charges scheme that has effect in relation to a period ending before 1 April 2018; **or**
- c) **for Welsh Undertakers** any charges scheme that has effect in relation to a period ending before 1 April 2020.

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 charges schemes confirming that:
- (a) the company complies with its legal obligations relating to the charges set out in its charges schemes;
 - (b) the Board has assessed the effects of the new charges on customers' bills for a range of different customer types, and approves the impact assessments and handling strategies developed in instances where bill increases for particular customer types exceed 5%;
 - (c) 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; and
 - (d) the company has consulted the Consumer Council for Water (CCWater) in a timely and effective manner on its charges schemes.
- A2 With the exception of new appointees, each undertaker should provide to the Water Services Regulation Authority a statement setting out any significant changes anticipated by the undertaker, and publish the statement, at least

three weeks before the publication of the charges schemes. The statement should include the following:

- (a) Confirmation of whether the undertaker is expecting there to be any bill increases of more than 5% from the previous year (for a given customer type assuming a constant level of consumption) and, if such increases are expected:
 - (i) what size increase is expected;
 - (ii) which customer types are likely to be affected; and
 - (iii) the handling strategies adopted by the company or why the company considered that no handling strategies are required.
- (b) Details of any significant changes in charging policy by the company from the previous year.

A3 In addition to the assurances set out in A1 above, new appointees' assurance statements must include assurance that their charges schemes offer:

- (a) levels of service at least comparable to the previous appointee's charges scheme;
- (b) prices that do not exceed those in the previous appointee's charges scheme for similar services; and
- (c) prices equivalent to those specified in the new appointee's application for each individual appointment or variation area.

A3 Draft modification – condition C (infrastructure charges)

If we decide on either options 2 or 3, the revised charges scheme rules would set out new rules for the calculation of infrastructure charges from 1 April 2020. Existing charging provisions for connections and new infrastructure would be replaced with charging rules for new connection services. Currently, the rules concerning the amounts that can be charged through infrastructure charges are set out in Condition C of the Welsh companies' licences. We would engage with the Welsh Companies on a proposal to modify Condition C of their licence on infrastructure charges that would:

- remove the current restrictions on the maximum amount of infrastructure charges from 1 April 2020; and
- provide that the existing restrictions on the maximum amount of infrastructure charges will continue to apply after 1 April 2020 in relation to connections where the existing charging provisions continue to apply under any transitional arrangements that the Welsh Government sets out when they replace the existing charging provisions in the WIA91.

We have provided an illustrative example of what such a change to Condition C may be, which is based on the change that was made to Condition of the undertakers whose areas are wholly or mainly in England. We would also propose a change to Condition D similar to the proposal recently consulted on that would preserve the requirement for water undertakers to inform wastewater undertakers of any new customers that are connected to their network.

Albion Eco currently only supply two large non-domestic customers and so unlike other NAVs do not have the provision in Condition B to prevent them from applying higher charges than the equivalent charges of the regional incumbent company. As this customer protection is not in place we would consider whether an alternative solution to the modification of Condition C is necessary for Albion Eco. However, given the number and type of customer that Albion Eco serves, and the benefits of simplifying their licence by removing unnecessary provisions, we do not think this is currently necessary. In the future, should a variation to its licence be requested by Albion Eco, we would consider if this position remained valid.

Whilst we will engage with the Welsh companies on this proposal as a separate process, we also welcome any comments on our proposed licence modifications at this stage, including the wording of the illustrative example.

A3.1 Proposed licence modification for large undertakers – 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 2020 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 2020 in the following circumstances:

(a) in relation to a Water Infrastructure Charge, if the premises are connected to a water main that;

(i) was provided by a water undertaker under section 41 of the Water Industry Act 1991 and the charges for that water main were calculated on the basis of the provisions of the Water Industry Act 1991 before they were amended by the Water Act 2014; or

(ii) was, or will be, adopted by a water undertaker in accordance with an agreement to which new charging rules do not apply; and

(b) in relation to a Sewerage Infrastructure Charge, if the premises are being connected to a public sewer that;

(i) was provided by a sewerage undertaker under section 98 of the Water Industry Act 1991 and the charges for that public sewer were calculated on the basis of the provisions of the Water Industry Act 1991 before they were amended by the Water Act 2014; or

- (ii) was, or will be, adopted by a sewerage undertaker in accordance with an agreement to which new charging rules do not apply.

16.3 In this paragraph “new charging rules” means rules about charges issued by the Water Services Regulatory Authority under section 51CD or 105ZF of the Water Industry Act 1991.”

A4 Draft impact assessment

A4.1 Introduction

This is our draft impact assessment on future charging rules for new connections for Welsh companies. We assessed the impact of two options and compared them against a counterfactual option (option 1, the status quo).

When assessing the case for change, we have taken into account documents and sources including:

- guidance issued to us by the Welsh Government (primarily their [2016 charging guidance](#), [2018 new connections charging guidance](#) and [2018 strategic priorities and objectives statement](#));
- our engagement with relevant stakeholders in Wales in early 2018;
- our previous experience of producing and monitoring the implementation of charging rules for England (see our [December 2016 decision document](#)); and
- responses to our consultation on our emerging thinking on charging for new connections (our [March 2016 emerging thinking document](#)).

In carrying out this impact assessment, we have taken into account relevant policy and guidance, including:

- our [policy on impact assessments](#);
- the [principles for economic regulation](#); and
- the [better regulation framework](#).

A4.2 Rationale for intervention

In this section we set out our rationale for intervention, in particular:

- **legislative and policy changes** which enable us to alter the current charging framework through new charging rules; and
- **market failures and inefficiencies** that regulatory intervention should be designed to address.

We set out issues with the current framework in our consultation document.

A4.2.1 Legislative and regulatory changes

The WA14 set out changes to the existing charging framework. Subject to commencement of the relevant sections, it enables us to set charging rules with which water companies must comply, and removes the requirement for us to approve companies' charging schemes.

The intention is to move to a regulatory framework that is proportionate, and where companies are accountable for their charges, must consult with their customers and provide an assurance statement demonstrating compliance with our requirements.

We are required to have regard to the Welsh Government's [guidance to us on new connections charges](#) when developing our charging rules.

A4.2.2 Market failures and inefficiencies

Water companies are regional monopolies which are subject to revenue controls that we set for revenue from developer services together with other revenue.

In the absence of further regulatory oversight, there is a risk of poor customer service standards with respect to charges. Water companies may not produce timely information, consult with stakeholders, or innovate.

In the absence of regulatory intervention, water companies have little incentive to publish charges that are transparent and enable a level playing field for contestable developer services.

A4.3 Options

We have considered three options in this impact assessment, for implementation in April 2020.

Option 1 – status quo

Under this option we would not propose to modify the current new connections charging framework for Welsh companies. If the Welsh Government and Defra commence the relevant parts of the WA14 that require Welsh companies to charge by reference to charging rules, under this option we would issue charging rules that match the current charging arrangement for Welsh companies.

Option 2 – principles-based rules

Under this option we would introduce a set of principles-based rules for new connection services for Welsh companies. This approach would be similar to the approach that we have taken when introducing rules for other charges as a result of the changes made by the WA14. This includes our charges scheme rules that related to charges to household customers in Wales and England; and the development of charging rules for new connection services that apply to English companies. It would differ from the new connection charging rules for English companies to have regard to Welsh Government guidance.

We would distinguish between site-specific charges and network reinforcements, with the latter being recovered by an infrastructure charge.

Option 3 – light-touch charging rules

For contestable services we would issue light-touch rules. These would primarily consist of principles, reflecting Welsh Government's guidance and our statutory duties.

As with option 2, we would distinguish between site-specific charges and network reinforcements, with the latter being recovered by an infrastructure charge.

A4.4 Our approach to assessment

We have assessed options 2 and 3 against the status quo (option 1).

Consistent with our policy on impact assessment, we have assessed impacts in the following areas:

- implementation and ongoing costs;
- consumer protection;
- the effect on competition;
- contribution to environmental sustainability;
- the contribution towards having regard to the Welsh Government's guidance;
- the contribution towards innovation; and
- good regulation.

A4.5 Option 2 – principles-based rules

By moving from rigid licence conditions to principles-based rules, option 2 enables Welsh companies to set charges that are more flexible and have been developed through timely and appropriate consultation with customers, ultimately addressing the principles that we set out in our charging rules.

Implementation and ongoing costs

Under this option there are a number of implementation costs compared to the status quo. We expect ongoing costs to be less than the status quo.

Welsh companies will have to consult and produce new charging arrangements. Developers and other customers such as SLPs may also have some one-off costs associated with adapting to the new charging arrangements. We will introduce a licence modification to remove the majority of the paragraphs within Condition C, develop and issue new rules. There may initially be additional casework costs associated with the new charging framework.

Based on information requests to stakeholders in Wales and our analysis, table A4.1 sets out our estimates for industry-level implementation costs over the first four years.

In response to our information request, Dŵr Cymru Welsh Water and Hafren Dyfrdwy supplied figures based on implementing different options. For customers' implementation costs we adjusted our figures from our impact assessment on implementing charging rules in England – we assumed reduced familiarisation costs due to English rules having been developed ahead of April 2018, and then adjusted the overall scale of costs according to the ratio of English to Welsh new connections.

Table A4.1 – Option 2 implementation costs (£m, 2018-19 to 2021-2022)

Stakeholder	Estimate (£m, NPV)
Incumbent companies	1.1
Customers	0.3
Ofwat	0.0
Total	1.4

We expect the net benefits that will be materialised over time under this proposal to outweigh significantly the implementation costs that will be incurred:

- **a better service for customers**, through charges that are predictable and transparent;
- the flexibility in the charging framework will encourage **greater innovation** in charging, for example to support more sustainable infrastructure, and greater responsiveness to change; and
- fixed upfront charges, including the fixed infrastructure charge to recover all network reinforcement costs, would result in fewer disputes, with consequential **lower ongoing costs** than the status quo.

Consumer protection

Consumers are affected directly by the rules only in the small number of cases where they are a new connection customer, or in terms of the extent to which costs are apportioned fairly between developers and other customers (with the latter including households).

Where the Welsh companies' approaches to charging fall short of the requirements set out in our charging rules, we have powers to enforce both the charging rules themselves and any competition concerns through our powers under the Competition Act 1998.

Our proposed charging rules require Welsh companies to ensure that the present balance of charges between developers and other customers is broadly maintained – and in line with Welsh Government guidance, Welsh companies should provide a clear rationale for their decision following effective consultation. We consider this to provide reasonable protection to end customers as a result of changes to the framework.

The effect on competition

Under this option, Welsh companies are required to make a clear distinction between contestable and non-contestable charges. In addition, our charging rules would enable us to require incumbent Welsh companies to ensure other participants are not disadvantaged, and that charges allow a level playing field for competition for contestable developer services. As with the status quo, competition law would also apply.

Contribution to environmental sustainability

Under this option, relative to the status quo, we will require the Welsh companies to determine charges that reflect the principle of environmental sustainability, and they would in turn have the flexibility in how they reflect this in their charging

arrangements. This is not possible under the current framework, and as such we consider this option to be a significant improvement.

We would also require Welsh companies to consider options for promoting the use of sustainable drainage systems (SuDS) by developers through their charging arrangements. This reflects guidance to us from the Welsh Government.

Welsh Government guidance

Under this option, we are able to set principles that reflect the Welsh Government's guidance to us: our charging rules would require charges to be simple and transparent; stable, predictable and timely; fair and cost reflective; and to promote environmental sustainability. We can further amend our rules to reflect any future guidance issued to us by the Welsh Government, whereas under the existing framework burdensome licence modifications would be required.

Innovation

Through more flexible charging arrangements, Welsh companies would be able to innovate in how they set their charges, which is not possible under the status quo. Welsh companies may for example introduce discounts that encourage developers to install more efficient water fittings, leading to overall lower demand and a more efficient allocation of resources.

Good regulation

Our charging rules will comply with good regulation principles. They will enable Welsh companies to set flexible charges, and for us to amend our charging rules over time to reflect new developments and changing circumstances. Our charging rules will be targeted, by seeking to address relevant issues only, and proportionate, because they are principles-based, and therefore less burdensome than the existing framework, and support innovation. They also ensure consistency with our approach for English companies.

Our approach also increases transparency, for example by requiring Welsh companies to consult on and publish their charging arrangements.

Option 3 – light-touch charging rules

Under this option Welsh companies would have the flexibility to set their charging arrangements based on high-level rules that we set out, but we would not prescribe detailed requirements that meet our objectives.

Implementation and ongoing costs

Under this option we will issue new light-touch charging rules and will introduce a licence modification to remove the majority of the paragraphs in Condition C. Welsh companies would have to produce new charging arrangements. Developers and other customers, such as SLPs, would need to familiarise themselves with the new charging arrangements. Certain customers, companies and ourselves may initially have additional casework costs associated with the new framework. These factors will all contribute to implementation costs at an industry level. The costs to customers would depend on the nature of Welsh companies' charging arrangements.

Table A4.2 presents implementation costs based on information requests and our analysis for the four years from 2018. In their response to us, Dŵr Cymru Welsh Water did not include potential dispute costs around interpretation of light-touch rules but noted that in their experience they can be costly and time-consuming.

Table A4.2 – Option 3 implementation costs (£m, 2018-19 to 2021-2022)

Stakeholder	Estimate (£m, NPV)
Incumbent companies	1.0
Customers	0.6
Ofwat	0.0
Total	1.6

We expect ongoing costs to be higher than option 2, and potentially also higher than the status quo, because the high level nature of the rules will mean that enforcement is more protracted and complex.

Consumer protection

Consumers are affected directly by the rules only in the small number of cases where they are a new connection customer, or in terms of the extent to which costs are apportioned fairly between developers and other customers (with the latter including households).

Unlike option 2, we would not set a rule relating to the balance of charges between developers and other customers, instead we would rely on high-level rules. It would be challenging for us to enforce customers' protections without more detailed charging rules.

The effect on competition

Under this option, companies are required to make a clear distinction between contestable and non-contestable charges. In addition, our charging rules would enable us to require incumbent Welsh companies to ensure other participants are not disadvantaged, and that charges allow a level playing field for competition for contestable developer services. As with the status quo, competition law would also apply.

However, given the high level nature of the rules, charges would be less transparent than under option 2. We would have to largely depend on casework and ex-post interventions to uphold this rule, and we would not set specific rules to address known issues.

Contribution towards environmental sustainability

Under this option relative to the status quo, we will require the Welsh companies to determine charges that reflect the principle of environmental sustainability, and they would in turn have the flexibility to reflect this in their charging arrangements. This is not possible under the current framework, and as such we consider this option to be a significant improvement.

Unlike option 2, we would not be able to set out specific rules to encourage SuDS, other than through these high-level principles.

Welsh Government guidance

Under this option, we will set principles that reflect the Welsh Government's guidance to us. We can further amend our rules to reflect any future guidance issued to us by the Welsh Government, whereas under the existing framework burdensome licence modifications would be required.

Unlike option 2, we would not address specific issues raised by the Welsh Government, such as promoting SuDS.

Innovation

As with option 2, through more flexible charging arrangements, Welsh companies would be able to innovate in how they set their charges, which is not possible under the status quo. Welsh companies may for example introduce discounts that encourage developers to install more efficient water fittings, leading to overall lower demand and a more efficient allocation of resources.

Good regulation

This option only partially meets the principles of good regulation. Light-touch charging rules would provide greater flexibility, enable innovation and reduce the administrative and legislative burden when companies set their charges. However it may not sufficiently address the issues identified by us and stakeholders. This approach may not be proportionate or targeted if it does not meet our objectives and leads to significant increases in casework.

A4.6 Our preferred option

We consider option 2 to be the best option. It meets our objectives and addresses issues identified by us and stakeholders.

This option permits flexibility and innovation by Welsh companies when they set their charges. Adopting principles-based rules enables us to periodically update them to reflect additional guidance issued to us by the Welsh Government and any further developments or evidence.

This option follows good regulation principles and does not impose an unreasonably heavy administrative burden on the large Welsh companies. We would consider the circumstances of Albion Eco separately to ensure that this option did not place an undue regulatory burden on this smaller company.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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