20 December 2018

Trust in water

Charges Scheme Rules, Wholesale Charging Rules and Charging Rules for New Connection Services (English Undertakers) decision document

Ofwat

www.ofwat.gov.uk

About this document

The Water Industry Act 1991 (**the Act**) (as amended by the Water Act 2014) allows the Water Services Regulation Authority (**Ofwat**) to set rules about the charges that a water and/or wastewater company can impose on its customers and on a water supply and/or sewerage licensee (**Retailer**). It also allows Ofwat to make amendments to these rules following a formal public consultation.

From 6 November 2018 to 20 November 2018, we undertook a statutory consultation on revising our Charges Scheme Rules, Wholesale Charging Rules and Charging Rules for New Connection Services (English Undertakers) (together for the purposes of this document the **Charging Rules**). In addition, we highlighted some errors in the existing Charges Scheme Rules and Charging Rules for New Connection Services (English Undertakers) that we intended to amend at the same time, although these changes did not form part of this consultation.

This document sets out our final position on these revisions to our Charging Rules. Our final position is consistent with our consultation. As a result, we are now changing these rules in accordance with 143(6A), 143B, 66E and 117I, and 51CD, 105ZF and 144ZA of the Water Industry Act 1991.

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

Contents

1 Introduction

This is a decision document on changes to our Charging Rules. The principal change relates to levying an infrastructure charge to recover network reinforcement costs reasonably incurred, which we announced as a temporary change in July 2018 and we are now making permanent.

On 1 April 2018, our Charging Rules for New Connection Services (English Undertakers) (the **New Connection Rules**) came into effect. These rules were developed in consultation with the sector and having regard to the charging guidance issued to us by the Department for Environment, Food and Rural Affairs (**Defra**). They aim to ensure that charges for new connections services enable and encourage efficiency, are fair and give certainty to suppliers and buyers. We originally published the New Connection Rules in December 2016 under sections 51CD, 105ZF and 144ZA of the Act. These were issued in addition to the Charges Scheme Rules which were initially issued in November 2015, and subsequently re-issued in December 2016 and June 2018 under sections 143(6A) and 143B of the Act.

As set out in Information Notice 18/14, in July 2018 we made temporary changes to the Charges Scheme Rules and the New Connection Rules to ensure that, regardless of the way that a new water or wastewater connection was made, water and wastewater companies were able to levy an infrastructure charge to recover network reinforcement costs they reasonably incur as a result of the provision or adoption of new water mains or public sewers and the connection of new premises. These changes were made as urgent revisions in accordance with section 143D of the Act (for the Charges Scheme Rules) and sections 51CF, 105ZH and 144ZC of the Act (for the New Connection Rules), and, as such, they only had effect for 6 months from the day after the revised rules were issued.

From 6 November to 20 November, we consulted on a proposal to make these temporary changes permanent. Consistent with the changes set out in Information Notice 18/14, we considered that the proposals would ensure that English water and

wastewater companies[1] are able to recover the reasonable costs of providing these services regardless of the methods by which the customer procures them.

In addition to this, we consulted on a proposal to revise the definition of 'Small Company' and 'Small Companies' in our Wholesale Charging Rules and our New Connection Rules to remove the reference to the Cholderton and District Water Company Limited, reflecting the termination of its licence. We also proposed to remove the reference to Cholderton and District Water Company Limited from the Annex of the Charges Scheme Rules.

The remainder of this document is structured as follows:

- Chapter 2 – Proposed rules changes;
- Chapter 3 – Responses to our consultation;
- Chapter 4 – Our decision; and
- Annex 1 – List of respondents.

[1] By "English water and wastewater companies" we mean water undertakers and sewerage undertakers whose areas are wholly or mainly in England.

2 Proposed rules changes

In this chapter we set out the legal framework and contents of our consultation.

2.1 Legal framework

We are required under sections 143(6A), 143B, 66E and 117I and 51CD, 105ZF and 144ZA of the Act to issue the Charging Rules, and are permitted under these sections, to revise rules issued and issue revised rules. Sections 143C, 66EB and 117K and 51CE, 105ZG and 144ZB of the Act set out the procedure under which we are able to make and amend the rules.

In accordance with sections 143C, 66EB and 117K and 51CE, 105ZG and 144ZB of the Act we must not issue the revised rules until 28 days after the consultation finishes (beginning with the day after the end of the consultation period).

2.2 Infrastructure Charges

The amendments that we proposed to make to our Charges Scheme Rules and our New Connection Rules are almost identical to those set out in Information Notice 18/14 of July 2018 and introduced as urgent (and therefore temporary) revisions.

The aim of the proposed changes were to make clear what network reinforcement costs English water and wastewater companies can recover through infrastructure charges. In particular, the changes were intended to make clear that infrastructure charges could be used to recover network reinforcement costs incurred regardless of the method by which water mains, public sewers or new connections are procured. We did not anticipate that the changes to our Charging Rules would require English water and wastewater companies to change the infrastructure charges that they are currently charging their customers.

When premises are connected to the public water or wastewater system for the first time, the relevant water or wastewater company is able to levy an infrastructure charge for each new water or wastewater connection. This charge is additional to the costs of any physical connection work and allows English water and wastewater companies to recover network reinforcement costs they reasonably incur as a result of the provision or adoption of new water mains or public sewers and the connection of new premises. This charge can be levied regardless of the method by which the new connection was procured or made.

Our policy on charging for network reinforcements, as set out in our July 2016 consultation document[2] on new connection charging and confirmed in our subsequent decision document[3], is to allow English water and wastewater companies to set infrastructure charges that cover all off-site network reinforcement works needed to support new development in their areas. This was intended to be the case regardless of the method by which developers or other customers procure water mains, public sewers or new connections.

However, we came to the view that the Charging Rules needed to be changed to make it clear that infrastructure charges could be used to recover network reinforcement costs incurred where new water mains, public sewers or connections were provided under an agreement (including an agreement with a Retailer in the business retail market) as well as where they were provided under a specific duty in the Act. This reflected the fact that English water and wastewater companies may not always provide new connection services under specific sections of the Act. We understood that this is the basis on which English water and wastewater companies have currently calculated their infrastructure charges and that is why we did not expect the changes to our Charging Rules to require any changes to current infrastructure charges.

The only types of agreement that we proposed to exclude for these purposes were agreements between water and wastewater companies in the form of **bulk supply agreements** and **bulk discharge agreements**.

To help ensure that the New Connection Rules and Charges Scheme Rules are consistent with each other, we also proposed amending paragraph 30 of our Charges Scheme Rules and the definition of “Network Reinforcement” in paragraph 5 of the New Connection Rules. This is because the Charges Scheme Rules use the “Network Reinforcement” definition set out in the New Connection Rules rather than defining this term in each set of rules seperately.

[2] https://www.ofwat.gov.uk/wp-content/uploads/2016/03/New-connections-charging-–-consultation.pdf
[3] https://www.ofwat.gov.uk/consultation/new-connections-charging-consultation/#Outcome

2.3 Definition of a Small Company

We proposed to revise the definition of 'Small Company' and 'Small Companies' in our Wholesale Charging Rules and New Connection Rules. These terms were defined to include references to Cholderton and District Water Company Limited. However, on 1 May 2018, the licence of Cholderton and District Water Company Limited was terminated for the reasons set out in our reasons document. As a result, we proposed to remove the references to Cholderton and District Water Company Limited from these definitions in both of these sets of charging rules.

We also proposed to remove the reference to Cholderton and District Water Company Limited from Annex A2 of the Charges Scheme Rules for the same reason.

2.4 Correcting minor errors in the Charging Scheme Rules and New Connection Rules

It came to our attention that the Charges Scheme Rules that were published on in December 2016 contain some minor typographic errors in the definition of the Mogden formula and in Rule 32. The New Connection Rules also have some minor formatting errors in the annex.

We therefore announced our intention to correct these errors when we issue the revised Charging Rules. However, these were not changes to policy or the meaning of the rules.

3 Responses to our consultation

In this chapter we set out the main points raised in responses to our consultation, and our responses to these points.

11 stakeholders responded to our consultation. The list of respondents is set out in Annex 1. We are publishing all of the substantive non-confidential responses alongside this document.

Most responses supported the proposed change and we did not receive any responses that were against the proposed change. We received one response which suggested an amendment to the proposed rules with respect to New Appointees and Variations (**NAVs**).

Most comments related to how the proposed changes to the Charging Rules for infrastructure charges apply in relation to NAVs. There was an additional comment relating to enforcement of our Charging Rules. These are discussed below.

Infrastructure charges and NAVs

Three substantive comments related to how the proposed rules for infrastructure charges apply for new developments where the incumbent water company is a NAV.

One respondent set out its interpretation of how infrastructure charges are collected by an incumbent company when new connections are made in an area served by a NAV. A second respondent asked for clarification on the meaning of and the expected outcome of excluding agreements with other water and wastewater companies (bulk supply and / or discharge agreements) from the circumstances under which a company can levy an infrastructure charge.

Our Charging Rules and the Act allow for the incumbent water or wastewater company to recover an infrastructure charge, which is a charge from any newly connected pemises for water or wastewater services. As a result, where premises are connected to the water or wastewater network for the first time in an area served by a NAV, it is the NAV that can levy the infrastructure charge on the owner of those premises.

In most cases, the NAV provides water and/or wastewater services to households and businesses via a bulk supply or discharge agreement with the regional incumbent company. These agreements typically require the NAV to pass some or all of the revenue it has received from infrastructure charges on to the regional

incumbent company to reflect the fact that it is usually the regional incumbent company that incurs the majority of network reinforcement costs associated with the new development in the NAV's area. However, this would be a function of the bulk supply and or bulk discharge agreement, which is a commercial agreement between the regional incumbent company and the NAV and is not subject to the Charging Rules.

The amendments that we proposed to the Charging Rules specifically excluded bulk supply agreements and bulk discharge agreements to make it clear that such arrangements would not result in the regional incumbent company being able to impose infrastructure charges directly on customers that are served by NAVs or the NAV itself through these charging arrangements. However, it would not prevent the regional incumbent from recovering infrastructure charges collected by the NAV through the arrangements set out in a bulk supply or discharge agreement. As a result, this proposal should not impact any agreements between regional incumbent and NAVs.

The third respondent that raised questions regarding the application of these rules where a NAV is involved had concerns about a company's approach to setting its infrastructure charges where the regional incumbent provides a bulk supply or a bulk discharge to a NAV. The respondent's concerns are that under the proposed change to the definition of network reinforcement, network reinforcement works that are necessary as a consequence of a new bulk supply agreement with a NAV could not be factored into the regional incumbent's calculations of the infrastructure charge that it sets for its customers. This is because the definition of network reinforcement excludes works that are the result of agreements with a relevant undertaker, such as a NAV.

Our Charges Scheme Rules and New Connection Charging Rules are designed to work together and impose rules which mean that the customers of an incumbent company only pay for the network reinforcement costs related to direct connections to the regional incumbent's own network. NAVs are not customers, and these rules exclude connections to a NAV's networks (with or without the proposed change).

A NAV's customers are not the regional incumbent's customers. Bulk supply and bulk discharge arrangements (and the charges payable by the NAV under them, which we understand normally includes an amount equivalent to the infrastructure charges made by the NAV to its own customers) are not dealt with under these Charges Scheme Rules or New Connection Charging Rules. These are a separate issue. Any question of whether NAVs should be paying more or less for network reinforcement costs associated with their bulk supply or bulk discharge arrangements should be dealt with separately.

While this does not appear to have a material impact on company infrastructure charges, we recognise that this may represent a change from the way that companies calculate their infrastructure charges currently. It is our understanding that companies include in their calculation of their infrastructure charges the expected costs of undertaking network reinforcement on their own network required as a result of new developments in NAV sites to which they have a bulk supply or discharge agreement. We also understand that they factor the number of new connections on NAV sites in this calculation. This issue is small compared to the benefits of the rule change we are making, and potentially without practical implication. But we will reflect further on whether it is proportionate to make a further change in due course to revert to the previous inclusion of NAV network reinforcement costs in the calculation of infrastructure charges.

Enforcement of our charging rules

One respondent raised concerns that there is "…not currently a way for Ofwat to enforce its guidance where the customer deals directly with the wholesaler which may be a more significant concern as this is the preferred route for customers purchasing connections."

An element of the retail exit regulations has unintentionally affected our new powers to enforce the New Connection Rules in some circumstances. Defra is considering how to address these issues through secondary legislation during 2019. As this consultation did not propose to alter our ability to enforce the Charging Rules we do not consider that this is a concern specifically relating to the proposals that were consulted on and therefore will not be dealt with here.

4 Our decision

4.1 Our decision

We have received no objections from stakeholders to our proposed revision of the Charging Rules other than the concerns about how our proposed rules apply when there is a NAV which we have addressed in chapter 3. We have not received a direction from the Defra not to make this revision. Hence we are issuing the revised Charging Rules on 20 December 2018.

The revised Charging Rules have been published alongside this document with the changes to the rules highlighted for clarity.

4.2 Updating some rules on requisitions

In July 2017 we made a minor change to our New Connection Rules.[4] This change provided an exemption from requirements to provide upfront fixed charges for requisitions. However, we did not issue a revised version of the New Connection Rules at the time. We are therefore including these changes, which add rules 47 and 48 into the consolidated version of the New Connection Rules.

[4] https://www.ofwat.gov.uk/consultation/new-connection-charges-for-the-future-england/

Annex 1 - List of respondents

1. Anglian Water
2. Bristol Water
3. Leep Water Network Limited
4. Northumbrian Water
5. Portsmouth Water
6. South East Water
7. South Staffordshire and Cambridge Water
8. South West Water
9. United Utilities
10. Yorkshire Water
11. The Consumer Council for Water

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.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

December 2018

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gsi.gov.uk.

OGL