

30 April 2019

Trust in water

**Consultation on charging rules for new connections and new developments for English companies from April 2020**

## About this document

This consultation relates to **water companies whose areas are wholly or mainly in England**.

The Water Industry Act 1991 (**the Act**) as amended by the Water Act 2014 allows us to set rules about the charges of water companies for new connections and developer services.

Within this legislative framework, this document is a statutory consultation on changes from April 2020 to the:

- [Charging Rules for New Connection Services \(English Undertakers\) \(New Connection Rules\)](#); and
- [Charges Scheme Rules](#).

These changes, for consultation, are to implement our [November 2017 decision](#) to change the way that income offsets are applied, to support a vibrant and competitive market for developer services, as well as to clarify our rules in relation to the balance of charges between developers and existing customers.

In addition we are consulting on a new information requirement to support the stability and predictability of bills for new connection services.

## Responding to this consultation

We welcome responses to this consultation by **28 May 2019**.

We prefer you to send your response by email to [charging@ofwat.gov.uk](mailto:charging@ofwat.gov.uk). You can also submit your response by post to:

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

We may publish responses to this consultation on our website at [www.ofwat.gov.uk](http://www.ofwat.gov.uk), unless you indicate that you would like your response to remain unpublished.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.

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## 1. Introduction

### 1.1 Scope of consultation

This document is a statutory consultation on changes to our charging rules from April 2020 onwards affecting new connection and developer services provided by English water companies (**companies**).

We are proposing changes to our charging rules to implement our [November 2017 decision](#) regarding treatment of key discounts, income offsets, to contribute to a level playing field in provision of developer services. The aim of this change is to support a more vibrant and competitive market for developer services, from which developers and other customers will benefit through more customer responsive service, service innovation and lower prices.

In addition, we are consulting on changes to support the stability and predictability of charges: we are clarifying our rules in relation to the balance of charges between developers and existing customers, and we are proposing a new information requirement with respect to increases in bills.

### 1.2 How changes to income offsets support competition

We explain the main financial flows and hence the rationale for our decision on income offsets here. More details on impacts for customers, for different types of new appointee (**NAV**)<sup>1</sup> and for other provider are set out in chapter 5.

When a developer requires a new water and/or waste water connection to a property, a request can be made to the incumbent water company or a NAV to provide the necessary infrastructure and service the property. Alternatively, developers may choose a contractor to install the necessary pipework, which is known as self-lay, and may be able to do some of the work themselves. In this case, the water company then will take over responsibility of that infrastructure from the self-lay provider (**SLP**) or the developer through an adoption agreement.

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<sup>1</sup> New appointment and variations provide water and/or sewerage services to customers in an area previously served by the incumbent monopoly provider. A new appointment is made when Ofwat appoints a company for the first time to provide services for specific geographic area. A variation is where an existing appointment is varied to extend the areas served.

Our charging rules distinguish between:

- **Requisition charges and other charges for site-specific work.** Many of these services are ‘**contestable**’ and can be provided by an undertaker (incumbent company or NAV), SLP or (primarily in the case of sewers) developers; and
- **Infrastructure charges for network reinforcements.** This covers incremental work needed to the incumbent water company's network due to new developments but not specific to an individual development. Network reinforcements are the responsibility of the water company.

‘**Income offset**’ currently discount requisition charges. They are applied in recognition of the revenues the water company will receive from new customers as a result of the new development. Effectively, income offset represents a contribution from existing customers of the water company to the recovery of developer services costs.

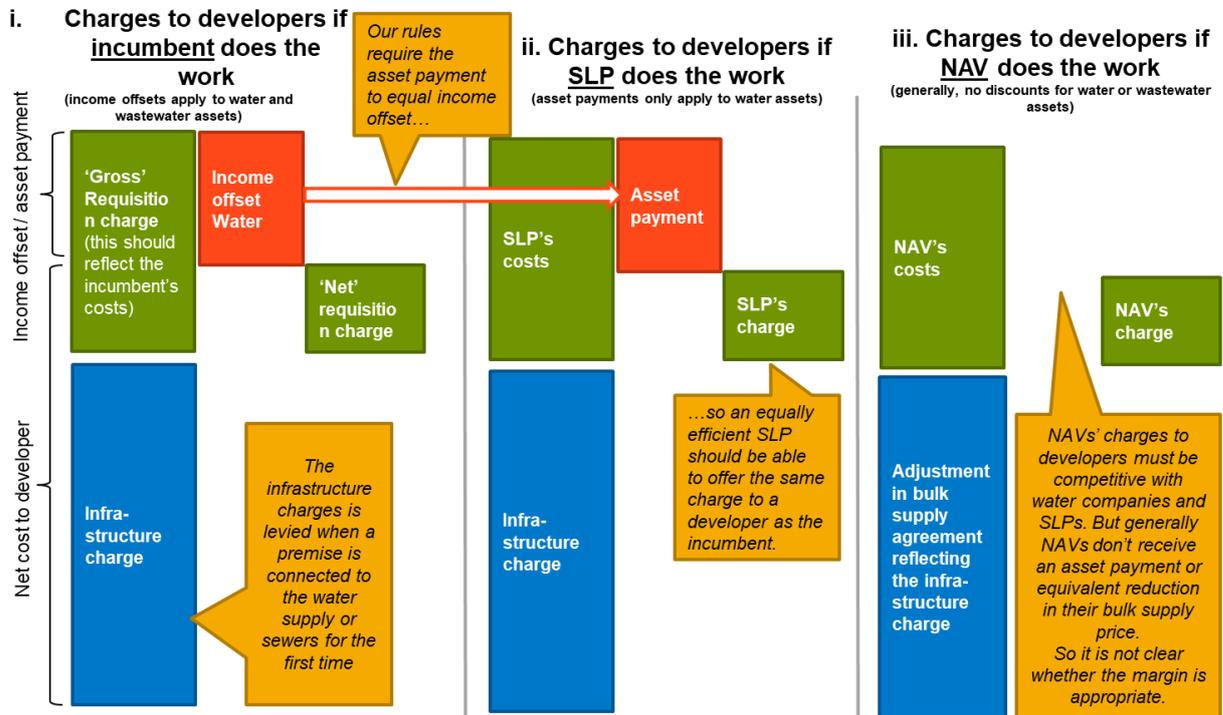
Under previous charging arrangements, the Act specified income offset as a formula relating to income the water company expected to receive from the new customers concerned over the first 12 years following the new connection.

Under the New Connection Rules there is no longer a prescribed model for calculating income offset, though companies are required to clearly explain their methodology in their charging arrangements. While companies have flexibility to develop their methodology for calculating income offset, it is subject to rule 19 which requires each company to ensure the balance of charges between developers and other customers is broadly maintained.

**Figure 1** shows the current arrangements under three scenarios: when the incumbent company lays the on-site infrastructure; when the SLP lays the on-site infrastructure; and when a NAV lays the on-site infrastructure, and serves the new customers, through a bulk supply agreement with the incumbent.

When the incumbent provides the on-site work, income offset is applied to requisition charges. When an SLP provides the on-site work, the incumbent company makes an asset payment to the SLP when adopting the new infrastructure. The asset payment is required to be equivalent to income offset if the incumbent had carried out the work. As NAVs do not receive an asset payment, because they retain control of the on-site infrastructure they provide, they do not benefit from an equivalent discount.

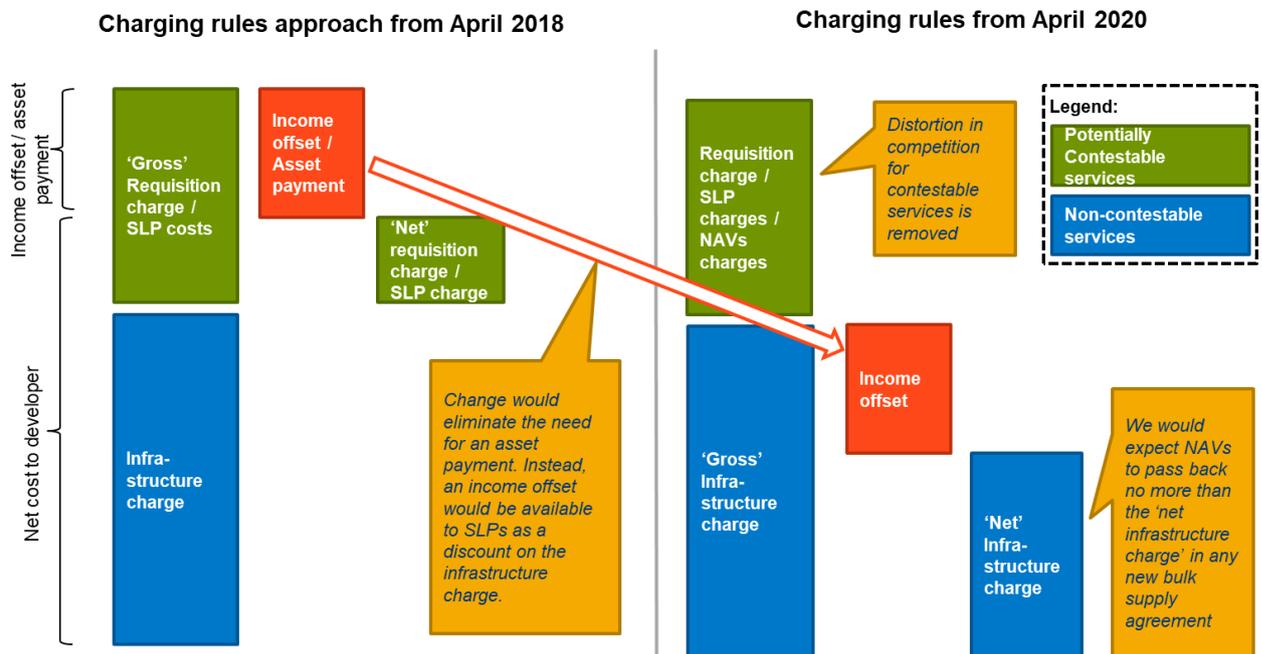
**Figure 1: Current treatment of income offset may disadvantage NAVs**



The November 2017 decision moves income offset to the infrastructure charges. With this change, NAVs effectively have access to the income offset discount. SLPs are not financially affected by the change because, although they are no longer entitled to an asset payment, they will still be competing on a level playing field with incumbent companies. This is set out in **Figure 2**.

Impacts of these changes for customers, stakeholders and industry, are set out further in chapter 5.

**Figure 2: Impact of moving income offset to infrastructure charges**



### 1.3 Structure of this document

The remainder of this document sets out our proposals. It is structured as follows:

- Chapter 2 sets out our ongoing work to improve developer services and some of the key issues related to charging for those services.
- Chapter 3 summarises our November 2017 decision to change the way income offset is treated. It also explains why we think it is necessary to provide some further clarification to rule 19 of the New Connection Rules on the balance of charges.
- Chapter 4 presents our proposal to introduce a new information requirement to support the charging principle of stability. We propose to implement this requirement through an information notice rather than changes to our charging rules.
- Chapter 5 sets out the impacts of the changes to the rules and implications for key stakeholders, issues for companies when implementing the new rules and our next steps to implement the rules.
- The tables in Appendix 1 list and provide commentary on the changes to the New Connection Rules and Charges Scheme Rules on which we are consulting.

We have also published marked up versions of our New Connection Rules and our Charges Scheme Rules for consultation.

## 2. Background and wider context

### 2.1 New Connection Rules

Historically, developers have faced problems with the ways that water companies provided and charged for new infrastructure. Actual charges could vary enormously from original quotations; there was little transparency regarding the off-site work undertaken and hence the basis for the associated charges, with a widespread perception of overcharging; and costs for network reinforcements were not fairly apportioned across different developments.

Some of these problems were associated with the legislative framework. Changes to legislation have enabled us to set charging rules for the first time, having regard to [Defra's charging guidance](#). This has allowed us to tackle key problems with the old arrangements.

Our New Connection Rules have applied from April 2018 for English companies<sup>2</sup>. Features of our rules include:

- Companies being required to publish charging arrangements including fixed charges for most services, allowing customers to calculate their bill in advance;
- Infrastructure charges for network reinforcements being required to be calculated and published on the basis of five year average costs, removing much of the largely arbitrary variation in these charges between neighbouring sites; and
- Companies being required to make it clear, through their published charging arrangements, that the majority of their services are contestable, and what charges for those services are, thereby enabling developers to more readily compare costs of alternative providers.

Ofwat developed its charging rules through extensive engagement with stakeholders. It was clear that individual charges would change as a result of the New Connection Rules, because we were revising definitions in order to increase

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<sup>2</sup> We are in the process of developing New Connection Rules for companies wholly or mainly in Wales. We consulted on our approach to setting these rules in [December 2018](#) and intend to have the new rules come into effect from April 2022.

charging transparency and predictability, and to support competition. Overall bills, however, were subject to protections. In particular:

- we introduced transitional arrangements for existing agreements to provide developer services (so that agreements made before the New Connection Rules were not adversely affected by the introduction of the New Connection Rules); and
- we introduced the ‘balance of charges’ rule intended to broadly maintain the level of bills for similar work overall.

## 2.2 Ongoing work to improve developer services

As well as introducing our New Connection Rules, we have been working with the industry in a number of areas to improve services to developers, including through supporting competition. This includes:

- **Levels of service reporting and D-MeX:** we challenged companies to develop and report against set levels of service that developers, SLPs and customers can expect in relation to the provision of housing development infrastructure. Companies have been reporting their results quarterly to Water UK since 2015. The resulting league table of performance has provided strong reputational incentives to improve service delivery. Building on this work, we are introducing the developer services measure of experience (**D-MeX**) as part of our 2019 price review (**PR19**). This is a mechanism to incentivise water companies to provide high quality customer experience for developer services customers, including property developers, SLPs and NAVs. The measure will be based on the combined results of feedback from a developer services customer satisfaction survey and a quantified measure of water company performance against a set of key metrics.<sup>3</sup>
- **Code for Adoption Agreements:** this code relates to self-lay infrastructure that is then adopted by the water company. We issued our Code for Adoption Agreements for English companies in November 2017. The code sets a framework of overarching principles within which companies must agree and maintain sector guidance and model adoption agreements, so that companies provide a more consistent approach to adoption agreements and more consistent information to relevant parties. Companies have submitted both

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<sup>3</sup> The quantified metrics will be based on Water UK’s existing [Levels of Service metrics](#) for developer services customers.

water and sewerage sector guidance and model adoption agreements to us. Subject to our review and any further improvements we may require, we anticipate the documents to come into effect from July 2019 for water and October 2019 for sewerage.

- **NAV initiatives:** we have taken actions to reduce barriers to NAVs to compete more effectively. We have set out those actions in our consultation on [Revisions to NAV Policy Guidelines](#). We have taken steps to improve the NAV application process and challenged the industry to develop a Code of Practice for bulk supply/discharge agreements. We also issued new [bulk supply charging guidance](#) in May 2018, which sets out our approach in making determinations if water companies fail to agree on the terms of their bulk agreement, and we are asked to make a determination about what the terms and conditions should be.

## 2.3 Charging issues

The New Connection Rules have been a major change for the industry and inevitably there are ways in which we can improve our rules and compliance with those rules. Issues have included companies not clearly explaining how some charges have been derived and what costs they were intended to recover, as well transparency and engagement concerns regarding amendments to charging arrangements. We have been working in a number of areas to make improvements:

- We have used our [Company Monitoring Framework \(CMF\)](#)<sup>4</sup> to highlight good and bad practice, and assessed companies' charging information. We considered two companies exceeded our expectations for the first year of their new connection charging arrangements; eight met our expectations; we had minor concerns regarding five companies, and serious concerns for the remaining two companies.
- As part of our proactive and reactive monitoring, we have [written](#) to water companies regarding compliance with competition law and charging rules obligations with respect to the self-lay market for new connections.
- We introduced changes to our [regulatory accounting guidelines](#) for 2017-18 reporting so that companies are required to show in detail expenditure on network reinforcement as a consequence of new connections. We have

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<sup>4</sup> The Company Monitoring Framework is one of the tools we use to hold companies to account and improve transparency. It is an assessment of water companies' assurance practices in relation to information they publish and provide.

proposed to introduce an additional reporting table for network reinforcements reconciliation in our [2019 Annual Performance Report consultation](#), which will provide commentary on the balance of costs and revenues each year from 2018-19 onwards.

- Through PR19, we have examined and benchmarked companies' costs for developer services. Unless companies have well justified reasons for higher costs, they will only be able to recover benchmarked costs through their 2020 to 2025 revenue controls.

We are considering a number of issues further, which we may seek to address separately through improved compliance or through changes to our rules on or after April 2021.

For off-site network reinforcement, our reforms have substantially improved bill stability and predictability. Our New Connection Rules have also sought to address Defra's Charging Guidance that "developer should not bear costs associated with enhancements to the existing network that are not a consequence of their new connections", and we have seen a number of companies' charges fall significantly as a result. Nevertheless, we think that there is further scope to improve cost reflectivity of infrastructure charges, as well as their transparency.

We are keen that water companies make more use of infrastructure charges that vary by geographical area (though, consistent with our Charges Scheme Rules, not typically for neighbouring developments, and retaining an averaging over time), to reflect different costs - for example, with new waste water infrastructure for remoter locations. Where costs do differ significantly by location, it is important to reflect these in charges, both to promote effective competition, and to improve transparency so that developers are better able to challenge whether appropriate cost effective solutions are being sought.

We also think that companies should be improving the cost reflectivity of individual charges and their description of what those charges cover, again to support competition and to increase transparency.

While this consultation is directed at addressing some of the distortions to competition that income offset creates, we may consider whether further reforms are merited to support competition – for example for full service NAVs who even with the policy changes set out in this consultation will not have full access to the income offset discount - and to have regard to Defra's Charging Guidance on the allocation of costs between developers and the general customer base.

### 3. Changes to our charging rules

We have powers, introduced by the Water Act 2014, allowing us to develop and update<sup>5</sup> charging rules for English companies. In doing so we must have regard to [Charging guidance to Ofwat](#) and [Water industry: guidance to Ofwat for water and sewerage connections charges](#) (**Defra's Charging Guidance**).

In this chapter, we recap on our November 2017 policy decision to change the way income offset is treated. In addition, we set out our reasons for wishing to clarify what is currently rule 19 of the New Connection Rules on the balance of charges.

The proposed changes to the rules are set out in Appendix 1.

#### 3.1 Implementing changes to income offset and removal of asset payments

Home builders (and ultimately end-customers) will benefit from a vibrant and competitive market for developer services through lower prices, better and more innovative services. So we want to see incumbent water companies, SLPs and NAVs compete on a level playing field.

A notable issue with the current approach to the new connection charges is that in most cases, NAVs do not have access to key discounts provided by water companies, namely income offset. This puts them at a competitive disadvantage.

After extensive consultation with stakeholders, we made a decision in November 2017 to change the way income offset is applied, with effect from April 2020. The aim of this change was to reduce some of the competitive disadvantage to NAVs by allowing them greater access to the income offset discount.

We concluded income offset should be applied to infrastructure charges instead of requisition charges, which will make it apply to developments that require connection to the incumbent water company's network regardless of who provides the on-site work. As a result, asset payments will no longer apply.

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<sup>5</sup> We can issue revised charging rules (subject to appropriate consultation) after they have first been issued.

We made this decision to support competition so that incumbent water companies, SLPs and NAVs would be on a level playing field. We considered this approach to treating income offset to be more transparent and predictable.

## 3.2 Clarification to the balance of charges rule

This section concerns what is currently rule 19 of our New Connection Rules, which relates to the balance of charges between developers and other customers. We are concerned at how a number of companies have interpreted this rule, and so to help rectify this we:

- explain the background and policy intent of rule 19; and
- set out an amendment to the rule, consistent with our original policy intent.

In our New Connection Rules, rule 19 states:

“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.”

Some of the original wording of our rule is taken from Defra’s Charging Guidance, as follows:

“These principles rest on the concept of fairness. It is the view of government that the current balance between contributions to costs by developers and bill payers should be broadly maintained. The general customer base should not bear costs in relation to new development and developers should not bear costs associated with enhancements to the existing network that are not a consequence of their new connections.”

We explained in our [December 2016 decision document](#) that both developers and other customers would be “protected from incidence effects because the balance of costs must remain broadly as it is now – this requirement reflects the view of government, as set out in their guidance to us, that the current balance between contributions to costs by developers and bill payers should be broadly maintained”.

As part of our ongoing monitoring of charging arrangements, in 2018 we reviewed how companies had interpreted rule 19, and how it was reflected in PR19 business plans. As part of this, we invited all 17 of the incumbent companies to receive individual feedback from us on their charging arrangements, and we spoke to most of these companies about how they had implemented rule 19.

The balance of charges is maintained by varying income offset. This is because our New Connection Rules require that all charges are cost reflective, and our Charges Scheme Rules require that the infrastructure charge is cost reflective. The only item that the rules do not require to be cost reflective is income offset. While companies appeared to understand this, a number of companies have been setting income offset without checking that the balance across all costs associated with developments and charges paid by developers was being maintained.

Some stakeholders expressed the view in their responses to the [July 2017 consultation](#) that ‘the balance of charges’ rule implied the actual amount of charges collected from developers would be broadly unchanged. We think that this may be a helpful way of considering the rule for like for like work, though change to volumes or characteristics of developments, or changes to incumbents’ market share for contestable work, should result in a change in charges levied.

As a pragmatic way to help address this, we are augmenting the rule to make it clear that balance of charges calculation is intended to cover all the charges to which Defra’s guidance relates, as set out in Section 3 of Annex A.

#### **Question – statutory consultation**

**Q1** Do you have any comments on the proposed wording for the New Connection Rules and Charges Scheme Rules (see Appendix 1 tables, and the rules for consultation), which will come into effect from April 2020.

## 4. Proposed information requirements to support bill stability

This section sets out our proposal for a new information requirement to support the charging principle of stability. To enable us to consult more flexibly than through the statutory process, we are not proposing to implement this requirement through changes to our charging rules, but rather through an information notice for 2020-21<sup>6</sup>.

Our general charging principles in the New Connection Rules include stability and predictability (Rule 18C). We propose to introduce a new information requirement to the “Expectations, assurance and information requirements for water company charges” for 2020-21.<sup>7</sup> It will require companies (excluding small companies / NAVs) to provide a statement on the impact of significant bill increases to demonstrate compliance with that rule. This would affect companies’ submissions to us in January and February 2020.

This change will improve consistency between our New Connection Rules and our other rules. As a comparison, both our Charges Scheme Rules and Wholesale Charges Rules currently include information requirements associated with significant increases in charges. For example, in the annex to the Charges Scheme Rules, it states:

“Each undertaker should provide to the Water Services Regulation Authority a statement setting out any significant changes anticipated by the undertaker....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

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<sup>6</sup> Under Licence Condition M of the Instrument of Appointment, we can require the provision of information for the purpose of carrying out our functions.

<sup>7</sup> Our latest Information Notice (IN 18/18) setting the requirements for 2019-20 can be found [here](#).

(iii) the handling strategies adopted by the company or why the company considered that no handling strategies are required.”

We propose that the information requirement is similar to that already in the Charges Scheme Rules. We will expect companies to demonstrate whether bills for typical developments have increased significantly and what handling strategies they have in place where such increases have materialised. This should include consideration of relevant charges covered by both the New Connection Rules and Charges Scheme Rules.

Rule 8 of the Charges Schemes Rules, which defines and includes provisions on infrastructure charges, requires that undertakers carry out impact assessments whenever nominal bills for a particular type of customer are increased by more than a fixed percentage. We are proposing to have an equivalent requirement for new connection and developer services bills, but in the information notice rather than the rules.

The key differences would be that:

- the information requirement would not be with respect to types of customer; instead it would be for typical, potentially illustrative or stylised, examples or case studies of new connection and developer services, covering all relevant charges including infrastructure charges and income offset. We would expect that this would include examples of typical packages of services for individual household customers; small developments; and medium and larger developments, reflecting the mix of developer services in the incumbent’s area.
- Unlike the ongoing costs of water bills, each development is one-off service and expenditure with an associated decision of whether or not to proceed with the development. We therefore do not think that the threshold should be 5% nominal, as with other customers, and we propose instead a 10% nominal bill increase. We think this threshold strikes a proportionate balance between providing greater bill stability and transparency and ensuring there is sufficient flexibility for companies to make necessary changes in a reasonable period of time.

Introducing these information requirements would give greater assurance to developers as it would deliver greater scrutiny on significant increases in bills. We invite stakeholders to provide views on the introduction of this information requirement.

### **Question – non-statutory consultation**

**Q2** Do you have any comments on our proposal to introduce an information requirement on bill stability? More specifically:

- Do you find the proposed requirement helpful in supporting the charging principle of bill stability?
- Is the suggested 10% threshold for significant bill increases appropriate for striking the right balance between more scrutiny on bill increases and flexibility for companies to make changes as necessary?

In order to assist companies in implementing this requirement effectively, we welcome views on:

- what criteria would be most appropriate to define typical new developments; and
- what services should be included in a typical package.

## **5. Implementation, impacts and next steps**

### **5.1 Introduction**

In this chapter we consider practical issues to support the successful implementation of these changes. Income offset will now be applied at a different stage in the process, and there will no longer be asset payments. It is important that this is reflected in water companies' systems and that customers and wider stakeholders understand this.

We first consider implications of these changes for developers and other customers, SLPs and NAVs. We then consider implementation issues for water companies, before setting out the complementary changes we will be making and our next steps.

As part of this consultation, we are asking for comments on implementation issues that we may not have identified.

### **5.2 Impacts on new connection customers**

The changes we intend to make to income offset mean that it is applied at a later point in the process of delivering the new connection service. Infrastructure charges are payable once a connection is made, whereas on-site works are completed at an earlier stage, so requisition charges are typically payable before the infrastructure charges. Companies will need to clearly communicate this change to customers as part of effective engagement in preparing their revised charging arrangements for April 2020.

Longer term, customers can expect to benefit from the improvements to developer services associated with stronger competition from NAVs, as well as the wider work that we and water companies are undertaking.

Water companies have choices around how they implement the changes to income offset. The changes we propose to make to our information requirements will support companies engaging with their customers and working to mitigate impacts for typical types of development or new connection service.

Overall, our balance of charges rule means that, broadly, developer services customers might expect to pay a similar proportion of the costs and consequential costs of those services relative to the equivalent pre-April 2018 charges. The clarification we are making to the balance of charges rule should support the original

policy objective that neither developers nor existing customers pay an increased proportion.

### **5.3 Impacts and implications for SLPs**

The changes to income offset and asset payments will change the arrangements that SLPs need to make with developers. SLPs will need to charge developers the full cost of their work because they will no longer be entitled to asset payments.

The changes will be cost-neutral for SLPs. As water companies will now be charging developers the full cost of their contestable work (income offset will no longer be net off charges for contestable work), SLPs will need to do the same (they should no longer net off the asset payment from their charges to developers), thereby competing on a level field.

We expect water companies and stakeholder representatives to clearly communicate these changes to SLPs.

### **5.4 NAVs**

This change is important for reducing barriers to competition for developer services, particularly in relation to NAVs. The changes made will mean that sites served by NAVs would have access to discounts equivalent to income offset, reducing barriers to entry.

In practice many appointments that have been made after 1 April 2018 are already benefiting because we have decided on a temporary measure that is equivalent to the income offset discount<sup>8</sup>. We have already seen a sharp rise in the number of NAV applications, perhaps as a consequence of this.

NAVs benefit from the change to income offset provided that they depend on the incumbent water company's network, and therefore pay for its network's reinforcement. Where a NAV proposes a treatment works on site, and does not propose to make use of the incumbent company's infrastructure, it would not have

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<sup>8</sup> The temporary measure is set out in our guidance on bulk supply charges to NAVs and applies from 1 April 2018 to 31 March 2019, at which point it will be superseded by the changes to our charging rules.

access to the discounts. As we have discussed in section 2.3, we may consider whether further reforms are merited to address this issue.

## **5.5 Implementation by water companies**

### **5.5.1 Transitional issues**

Infrastructure charges are paid at a later stage than requisition charges. This may raise a risk that income offset might be applied twice for an individual development if requisition charges happened to be paid before 1 April 2020 and infrastructure charges after 1 April 2020. There may be similar issues with asset payments, if an asset payment was provided for adopting the on-site infrastructure before 1 April 2020 and the infrastructure charge is due after that date.

Our charging rules give water companies flexibility about if and how they apply income offset, though it is required to be set out clearly in their charging arrangements (or charges scheme under the proposed changes). This means they can choose not to apply income offset for developments where it has already been applied for requisitions. It would go against the general charging principle of 'fairness and affordability' for developers to receive a double discount. Therefore we expect water companies to use the flexibility afforded to them by our rules to address this issue.

### **5.5.2 How water companies implement the changes**

Water companies have choices around how they implement income offset for 2020-21 and subsequently. Their charges should of course satisfy legislative and regulatory requirements, in particular our New Connection Rules and, within those, the principle that they promote effective competition for contestable work.

In accordance with the New Connection Rules principles of stability and predictability, water companies should look to implement the changes in a way that manages and mitigates significant increases in overall bills associated with individual sites relative to the previous year. For example, as income offsets are currently applied to requisition charges, which are proportionately greater for larger sites, companies could publish income offsets that are proportionately greater for sites with a larger number of new connections.

## 5.6 Complementary changes in how we regulate

For 2020-21 onwards, we will need to revise our guidelines on companies' performance reporting with respect to network reinforcements to take account of the change in treatment of income offset. We will publish the revised guidelines in summer 2020.

We concluded on [revised guidance](#) on bulk charges for NAVs in May 2018. Companies are now publishing their bulk charges taking account of our guidance. Companies have already prepared their bulk charges taking account of our decision on income offset. We are monitoring how companies are interpreting our guidance, and we may consider issuing supplementary guidance or issue charging rules on bulk services in the future.

## 5.7 Implementation and next steps

In accordance with sections 143C and 51CE, 105ZG and 144ZB of the Act, we are able to stipulate the consultation period within which persons may make representations about the proposed rules. In this instance, due to the complexity of the changes that we are proposing, we consider that a 28 days consultation is appropriate.

Following the closure of the consultation we will consider the responses received and whether any amendments are required to the proposed changes to the New Connection Rules and Charges Scheme Rules. In accordance with 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).

Following this, we propose to publish a decision document and revised New Connection Rules and Charges Scheme Rules, to take effect from 1 April 2020, in a time frame that will give water companies sufficient time to develop their charging arrangements and effectively consult with stakeholders and customers on them ahead of April 2020.

## Appendix 1: Proposed changes to rules wording

Tables 1 and 2 set out proposed changes to the New Connection Rules and Charges Scheme Rules respectively relative to the current versions of those rules, together with the rationale for the changes. As set out in this consultation document, the proposed changes are to:

- implement the November 2017 decision to move income offset from requisition charges to infrastructure charges; and
- clarify the rule about maintaining the balance of charges between developers and other customers.

In preparing these rules, we have taken into consideration the responses to the July 2017 consultation, which set out draft changes with respect to income offset and asset payments to the relevant rules.

Implementing these changes is made more complex because the infrastructure charge is in the Charges Scheme Rules rather than in the New Connection Rules. Therefore, we propose to move income offset to the Charges Scheme Rules and propose changes to both sets of rules.

For the avoidance of doubt, this appendix summarises our proposals. Please see [New Connection Rules for consultation](#) and [Charges Scheme Rules for consultation](#) for the full set of proposed changes.

**Table 1: Proposed changes to the New Connection Rules from April 2020**

Extant Rule Number	Change to Rule Wording	Rationale
5b	b) “ <b>Charging Arrangements</b> ” means a document setting out the charges, <del>Income Offsets and Asset Payments</del> , and/or the methodologies for calculating <del>them</del> <del>those</del> , applied by the water or sewerage undertaker in accordance with these rules.	Although we will be retaining the definition of Asset Payments, they should no longer be offered. References to Income Offsets will be transferred to

		the Charges Scheme Rules.
5d	<p><b>“Charges Scheme Rules”</b> means the Charges Scheme Rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991.</p>	Insert this definition to improve cross referencing between two sets of rules.
5l	<p><b>“Income Offset”</b> has the meaning given in the Charges Scheme Rules. <del>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:</del></p> <ul style="list-style-type: none"> <li>i) <del>supplies of water to premises connected to the new Water Main; or</del></li> <li>ii) <del>sewerage services to premises connected to the new Sewer.</del></li> </ul> <p>and <del>“Income Offsetting” shall be construed accordingly.</del></p>	The current definition is deleted and replaced with a cross reference to the Charges Scheme Rules.
5m	<p>Insert new rule as follows:</p> <p><b>“Infrastructure Charge”</b> has the meaning given in the Charges Scheme Rules;</p>	Inserted for clarity.
17a, 17b	<p>These rules apply to a Small Company subject to the following provisions:</p> <ul style="list-style-type: none"> <li>a) a Small Company is not required to publish one or more of the charges <del>or Asset Payments</del> 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);</li> <li>b) the charges imposed, <del>or Asset Payments made,</del> by a Small Company under the provisions of the Water Industry Act 1991 covered by these rules must be calculated in accordance with the principles and requirements set out in these rules whether or not they are published in Charging Arrangements and this includes, where relevant, requirements to provide the option of upfront Fixed Charges;</li> </ul>	Asset payments should no longer be offered.
19	<p>In setting charges in accordance with the present rules, undertakers should take reasonable steps to ensure that the <del>present</del> balance <del>of charges</del></p>	Clarify the balance of charges rule.

	<p><del>between Developers and other customers prior to the implementation of these rules</del> contributions to costs by Developers and other customers prior to 1 April 2018, is broadly maintained. Section 3 of Annex A to the Government’s Charging Guidance to Ofwat published in January 2016 lists the charges under which Developers contribute costs relevant to this rule. For the avoidance of doubt, Income Offset also needs to be included. 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.</p>	
21	<p>Charges <del>(including any Income Offsets), any Asset Payments</del> and arrangements for when they are each payable must be set in accordance with the principle that they should promote effective competition for Contestable Work.</p>	<p>Asset payments should no longer be offered. References to Income Offsets will be transferred to the Charges Scheme Rules.</p>
29	<p><del>In setting Requisition Charges an undertaker may (but is not required to) provide for an Income Offset.</del> Undertakers shall not provide for Income Offsets in setting Requisition Charges.</p>	<p>Income Offset is to be set against the Infrastructure Charge instead.</p>
30	<p><del>Not used As regards the methodology for the calculation of Income Offsetting arrangements:</del></p> <p><del>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;</del></p> <p><del>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</del></p>	<p>No longer needed.</p>

	<p><del>e) 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</del></p>	
35	<p>Each undertaker shall set out in the applicable Charging Arrangements the charges to be imposed <del>and the Asset Payments, if any, to be made</del> in respect of an agreement under section 51A or section 104 of the Water Industry Act 1991.</p>	Asset payments should no longer be offered.
38	<p>Insofar as section 51A agreements are concerned, water undertakers shall <b>not</b> provide for Asset Payments <b>for the adoption of a Water Main. where the undertaker calculates the requisition charge for a Water Main to include an Income Offsetting arrangement.</b></p>	Asset payments should no longer be offered.
39	<p>Insofar as section 104 agreements are concerned, sewerage undertakers <b>shall not provide for Asset Payments for the adoption of a Sewer.</b></p>	Asset payments should no longer be offered.
40	<p><b>Not used</b> <del>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.</del></p>	Asset payments should no longer be offered, so this rule is redundant.

**Table 2: Proposed changes to the Charges Scheme Rules from April 2020**

Extant Rule Number	Proposed Change to Rule Wording	Rationale
5	<ul style="list-style-type: none"> <li>• <b>“New Connection Charging Rules”</b> means the Charging Rules for New Connection Services (English Undertakers) issued by the Water Services Regulation Authority under sections 51CD, 105ZF and 144ZA of the Water Industry Act 1991;</li> <li>• <b>“Contestable Work”</b> has the meaning given in the New Connection Charging Rules;</li> <li>• <b>“Income Offset”</b> means a sum of money offset against an Infrastructure Charges in recognition of revenue likely to be received by the relevant undertaker in future years for the provision of:               <ul style="list-style-type: none"> <li>i. supplies of water to the premises connected to the new Water Main; or</li> <li>ii. sewerage services to the premises connected to the new Sewer.</li> </ul> </li> </ul> <p>and “Income Offsetting” shall be construed accordingly.</p> <ul style="list-style-type: none"> <li>• <b>“Sewer”</b> has the meaning given in the New Connection Charging Rules;</li> <li>• <b>“unmetered charge”</b> means a charge for services that are not based on measured quantities of volume to any extent; and</li> <li>• <b>“Water Main”</b> has the meaning given in the New Connection Charging Rules.</li> </ul>	Cross referring to definitions in the new connection charging rules
Amend heading before rule 26	Infrastructure charges and Income Offsetting (English undertakers)	
28	Infrastructure Charges must be determined in accordance with the principle that the amount of such charges will over each period of five consecutive Charging Years ending on 31 March 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	Clarify the rule in relation to the Income Offset.

	that the relevant undertaker receives for Network Reinforcement, and before the application of any Income Offset.	
31	<p>Insert new Rule 31 as follows:</p> <p>In setting Infrastructure Charges an undertaker may (but is not required to) provide for an Income Offset. Each undertaker has discretion as to the methodology to be applied to calculate the Income Offset.</p>	Rule for the Income Offset.
32	<p>Insert new Rule 31 as follows:</p> <p>In setting charges in accordance with the present rules, undertakers should take reasonable steps to ensure that the balance between contributions to costs by Developers and other customers prior to 1 April 2018 is broadly maintained. Section 3 of Annex A to the Government's Charging Guidance to Ofwat published in January 2016 lists the charges under which Developers contribute costs relevant to this rule. For the avoidance of doubt, Income Offset also needs to be included. 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.</p>	Rule for balance of charges.
34 (previously rule 32)	<p>In making charges schemes, each relevant undertaker must ensure that:</p> <ol style="list-style-type: none"> <li>a) charges schemes clearly set out how Infrastructure Charges have been calculated;</li> <li>b) the amount of Infrastructure Charges applied in respect of the modification or redevelopment of existing buildings or premises is determined in accordance with the principle that the amount must take due account of any previous usage in the 5 years before the modification or redevelopment began (including supplies of water that were not for domestic purposes and drainage that was not for domestic sewerage purposes) associated with the buildings and/or premises to which the charges are to be applied and be discounted accordingly;</li> </ol>	Income offset methodology is now relevant in Charges Scheme Rules.

	<p>c) charges schemes clearly explain the methodology to be applied for determining a discount to reflect previous usage; and</p> <p>d) charges schemes clearly explain the methodology to be applied for determining any Income Offset.</p>	
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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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