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## Reasons for the modification to the definition of “Excluded Charges” in Condition B of the licences of the 17 largest water companies

### Introduction and background

This notice explains the background and reasons for the decision of the Water Services Regulation Authority (**Ofwat**) to agree with each of the 17 largest water companies<sup>1</sup> a modification to the definition of “Excluded Charges” in Condition B of their appointments (**licences**).

In July 2019 [we consulted](#) on whether the list of Excluded Charges in Condition B should include amounts payable in relation to diversions other than those required by section 185 of the Water Industry Act 1991. The effect of this change would be to exclude revenue for these activities from the scope of the price controls we are setting for the 2020-2025 period. A “diversion” is, in this context, when a water company is required to move an existing water main, sewer or other apparatus at the request of a third party.

This notice confirms that the change has now been made in accordance with the provisions of the definition of “Excluded Charges” in paragraph 2 of Condition B of the licences of each of the 17 largest water companies, which permit that definition to be modified by agreement between Ofwat and the company concerned.

We will publish more information about the implications for price controls, and details of companies’ responses to our consultation, when we publish our price review final determinations.

The modification has been made for 11 companies holding appointments as both water and sewerage undertakers:

- Anglian Water Services Limited, Dŵr Cymru Cyfyngedig, Hafren Dyfrdwy Cyfyngedig, Northumbrian Water Limited, Severn Trent Water Limited, Southern Water Services Limited, South West Water Limited, Thames Water Utilities Limited, United Utilities Water Limited, Wessex Water Services Limited and Yorkshire Water Services Limited.

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<sup>1</sup> By “water companies” we mean companies holding appointments as water undertakers and/or sewerage undertakers under the Water Industry Act 1991.

The modification has also been made for 6 companies that only hold appointments as water undertakers:

- Affinity Water Limited, Bristol Water plc, Portsmouth Water Limited, South East Water Limited, South Staffordshire Water plc and Sutton and East Surrey Water plc.

The modification came into effect on 15 November 2019 for all the water companies concerned except Northumbrian Water Limited. The modification came into effect on 21 November 2019 for Northumbrian Water Limited.

## **What licence modifications have we made and why have we made them?**

The definition of “Excluded Charges” in paragraph 2 of Condition B of the relevant licences has been modified to include a new sub-paragraph (2A) reading as follows:

“In relation to the period from 1 April 2020 to 31 March 2025, amounts payable in relation to the alteration or removal of any relevant pipe (as defined in section 158 of the Water Industry Act 1991) or other apparatus that the Appointee is required to carry out under the New Roads and Streets Works Act 1991 or any other statutory provision except a provision of the Water Industry Act 1991.”

The effect of this change is to exclude revenue for these activities from the scope of the price controls we are setting for the 2020-2025 period.

For greater clarity, the wording of the modification has been slightly amended from the wording we proposed in July 2019 to make it clear, for the avoidance of doubt, that the new Excluded Charge will not cover amounts payable under any provision of the Water Industry Act 1991 in relation to the alteration or removal of any relevant pipe or other apparatus. The new Excluded Charge says “except a provision of the Water Industry Act 1991” instead of our original suggestion of “except section 185 of the Water Industry Act 1991”.

This does not involve any change to the approach we proposed (the exclusion from price controls of amounts payable in relation to diversions other than those required by section 185 of the Water Industry Act 1991), it is just a clearer definition. Although diversions are dealt with in section 185, we want it to be clear that none of the amounts payable under any other provision of the Water Industry Act 1991, for example in relation to a connection or requisition, fall within the new Excluded Charge even if part of the relevant work could be described as involving the alteration or removal of a relevant pipe or other apparatus.

We have made the decision to agree to the modification for the reasons we set out in July. The change addresses the two key issues we identified:

- **Our cost model does not allow us to project major jumps in diversions expenditure.** As part of our 2019 price review United Utilities submitted a cost assessment claim of around £100m based on a projected, large increase in diversions expenditure. This large increase in diversions was driven by diversions other than those requested under section 185 of the Water Industry Act 1991, for example due to High Speed 2 (HS2). This projected step change in diversions may not be fully captured in our base historical cost models that use historical costs.

Severn Trent Water also raised concerns that our approach to developer service reconciliation would not take account of some sources of uncertainty, including differences between forecast and actual diversions numbers and HS2 uncertainty.

- **The expenditure is relatively unpredictable.** United Utilities acknowledges that such diversions are uncertain and therefore the actual level of expenditure required over 2020-2025 is unpredictable. This means that, even if we were to establish a central estimate for this type of expenditure, actual expenditure could end up being significantly different from this. This would expose customers and companies to significant financial risk.

We also note that legislation that requires water companies to carry out diversions (such as the New Roads and Street Works Act 1991) also limits the amounts that companies can recover by reference to their costs. This provides protection to customers from abuse from any market power of water companies. Companies also face reputational incentives related to cost efficiency, although we recognise that the overall incentive for cost efficiency is weaker than if the revenue concerned remained within price controls.