



Ofwat
Centre City Tower
7 Hill Street
Birmingham
B5 4UA

Via email: charging@ofwat.gov.uk

16 September 2020

Dear Sirs,

**Re: Charging arrangements for new connection services for English companies:
comparative analysis and consultation**

Thank you for providing us with the opportunity to respond to this consultation on the charging arrangements for new connection services for English companies. Affinity Water are supportive of collaboration across the industry on this topic and are also committed to ensuring our charges align with the principles set out by Ofwat in the charging rules. This consultation is very timely as we are currently progressing work on our 2021/22 charging arrangements and will be actively engaging with our customers (Medium/Large Developers, Small Home Builders, NAVs and SLPs) on this topic commencing with our engagement event in October.

Overall, we are supportive of the high-level scope identified for the proposed working group which focuses on terminology and presentation; however, we are concerned about the potential to reveal sensitive commercial information relating to charges, such as contractor rates. While we acknowledge that this may be considered low risk if the discussion remains solely focused on terminology and presentation, we would request assurance that any competition risks are mitigated appropriately. Our preference is that any amendment to the new rules to establish a working group also includes appropriate safeguards that will serve to mitigate these risks.

In addition, we request that further consideration is given to the introduction of cost-reflectivity as a principle and its relationship between other principles, such as predictability and stability, where we feel adverse tensions may be created as cost-reflectivity may result in more frequent changes.

We would gladly be involved in the proposed new connections charges working group and help promote collaboration within this area. We intend to actively encourage our customers to also be part of this process and ensure any agreed terminology definitions align with the understanding across our entire developer customer base.



I hope you find our comments helpful. Please do not hesitate to contact me should you wish to discuss any of these points further.

Yours sincerely,

A handwritten signature in blue ink, appearing to read "Steve Hervouet", written over a set of horizontal lines.

Stève Hervouet
Director of Regulation and Strategy, Affinity Water

cc:
Pauline Walsh, Chief Executive Officer, Affinity Water
Graham Turk, Director of Production and Supply, Affinity Water

Consistent terminology

“We propose to add to the common terminology in the new connection rules, from April 2022 onwards, as set out in the glossary in Appendix 1 to this consultation.”

Q1: Do you agree with our proposal on common terminology and the way we propose to implement it? What do you think would be the impact of harmonising terminology for charges for new connection services?

We understand the importance that as an industry we should attempt to move towards using consistent terminology to support our developer customers in understanding charges associated with developer services activity. We support the inclusion of common terminology in the new connection rules from April 2022 should this timeline be agreed as acceptable, depending on the defined and agreed scope. Overall, we believe the impact of harmonising terminology will be a positive change and help make water companies charging arrangements clearer and more accessible.

However, we have some concerns regarding the feasibility and commercial aspects of this proposal and request that Ofwat consider the issues we set out below.

We are concerned that the work could lead to the sharing of sensitive commercial information, such as agreed contractor rates. This may be a low if the discussion remains solely focused on terminology and presentation, however we would like assurance that this concern is mitigated appropriately.

It is important to Affinity Water that any changes to terminology benefit all our developer customers, not just those identified as larger developers, self-lay providers (SLPs) and NAVs who may work across boundaries. While we acknowledge these customer groups as important stakeholders, when considering this topic, we would also like the consistent terminology that is eventually adopted to be endorsed and understood by our smaller home builders and one-off customers.

It is also essential to note that attempts have been made by the industry to promote consistency in terminology previously which have not been successful. Therefore, we request that appropriate timelines are given and there is a clear and mutually agreed scope prior to commencement, to ensure that April 2022 is a realistic date for implementation.

Q2: Do you agree with the definitions in the glossary (Appendix 1)? Please tell us what definitions you would amend, remove or add.

We have reviewed the definitions provided and have provided comments against this terminology in Appendix 1 of this response document.

We would be extremely interested in feedback from our developer customers with regards to this set of definitions and ask that a final list is compiled collaboratively with developers, SLPs and NAVs. Given that this is an opportunity to make our charging arrangements more accessible to our developer customers, we believe this engagement is vital to ensuring a higher level of confidence and understanding of charging arrangements across the industry.

Presentation of charges

“Clear worked examples help customers understand charges and how they apply in different scenarios, in particular by showing the services included in the calculation of the costs under each scenario and the unit costs of those service. We propose to improve practice in this area through our annual information notice “Expectations, assurance and information requirements for water company charges”. We have set out scenarios for typical service packages in the 2020/21 requirements and we propose to set out more explicit expectations on how companies present them, disaggregated by service and unit cost, for the 2021/22 charging arrangements”

Q3: Do you agree with the proposal to set out explicit expectations on the presentation of worked examples? What do you think would be the right level of detail to be required?

In general, we support the inclusion of worked examples which we think help companies to comply with the general charging principles of affordability, stability and predictability of charges. By providing worked examples, in theory, customers can cost their own development schemes using information provided by companies. These worked examples also provide market information in the form of inter-company comparisons which can be useful for both customers and water companies.

We also think it is helpful to add adequate commentary to worked examples to ensure that exogenous factors can be identified in order to avoid inappropriate inter-company comparisons and request that Ofwat takes this into account when setting out their expectations.

Analysis of charges

“We have found large variations in both the level of charges and the way in which companies have set out individual services”

Q4: Please highlight any substantive areas of our analysis you think are missing or could be improved.

We feel the comparative analysis which has been undertaken to inform this consultation is sufficient, with clear indicators as to why differences across companies may arise.

Q5: What do you think are the reasons for the differences in charging levels? Do you think these differences are a problem? Please provide evidence to support your views where possible.

Since the introduction of New Connection Charging Arrangements in 2018, there will naturally be differences in the way water companies have structured their charges. We believe the main factors impacting charging variations relate to the geographic variation amongst water companies and differing contractual agreements.

The geographical location of a water company has the potential to influence labour and overhead costs to support developer services functions. As these costs are built into new connection charges, they could cause a variation in cost between water companies. There are also factors such as land cost, construction cost, and housing market variations which could factor into the level of development activity in the area which may dictate the availability of resource to complete the work. We believe Ofwat have covered this well in the consultation document when referring to the exogenous factors relating to divergence in charges across companies.

In addition to the above, contractual agreements play a large role in the structure and build-up of construction related charges passed onto to developer services customers. Many water companies enter into their own contractual arrangements for the delivery of developer services work and can differ considerably in the approach taken. In addition, contractor rates may be more expensive in some areas which in turn, impacts the overall cost of being able to carry out works for developer customers, which would then be passed through to the water company as per their contractual arrangements.

Cost-reflectivity principle

“We consider that the differences in levels of charges are so marked that they are unlikely to be a function of cost alone. Such problems may undermine key principles of our rules, including that the charges are predictable, transparent and fair. While we expect charges to reflect costs, we feel our charging rules could have more explicit requirements to this effect. We propose to introduce a more explicit cost reflectivity principle in the charging rules, likely to be from 2022/23.”

Q6: Do you agree with our proposal to modify the Charging Rules for New Connection Services to explicitly include cost-reflectivity in the general principles? What other measures, if any, could be put in place to provide greater assurance that water companies’ charges are cost reflective?

We support the principle of cost-reflectivity and feel it is an essential mechanism to facilitate a fair basis for competition between incumbents, SLPs and NAVs in infrastructure provision. Cost-reflective charging would also mean there were lower risk of undue cross subsidy in charges for different types of developments, or more widely, between tariff customers and new connection customers. Therefore, we can anticipate benefits in including a charging rule relating to cost-reflectivity within the general principles in the charging rules.

However, it is important to recognise the potential for tension between a new cost-reflectivity principle and other charging principles, requiring i) affordability and ii) stability and predictability in charges. Where there are gaps between costs and current charges, the principle of cost-reflectivity implies an acceleration of the price changes needed to bring charges up to cost-reflective levels. The changes required may be too large in a single year to also satisfy the affordability and stability principles. If Ofwat intends to introduce a cost-reflectivity principle, it must also be prepared to accept that a potential consequence is more frequent changes to charges.

In relation to the above, we therefore suggest that cost-reflectivity may not be possible straightaway for all water companies where long-term commercial arrangements have been agreed with supply chain partners. Some contracts may have been agreed prior to the introduction of the new connection charging arrangements, which has been the case for Affinity Water. However, we are currently going through a new procurement process where we will be assessing cost-reflectivity levels. This will be complete for 2022/23, though we are aware that other water companies may not have the same opportunity within this timescale.

We believe it would be best to let companies, in consultation with new connection customers, judge how to balance the tensions between these principles and how quickly to adjust charges towards cost reflectivity. This requires a recognition from Ofwat in its approach to enforcing charging rules, that where principles are in tension, companies need to reach an appropriate balance and be given time to transition charges toward cost-reflective levels.

Industry Collaboration

“Industry collaboration can be an effective way to deliver more consistent and clear methodologies for the benefit of customers. We propose that a working group on New Connection Charges is established to improve consistency in terminology and presentation of charging arrangements and to develop common charging methodologies, to be led by Water UK”

Q7: What do you think are the benefits and disbenefits of having common charging methodologies? Do you think companies should adopt common methodologies?

We are committed to collaborating across the industry with the aim of producing consistent terminology and presentation of charging arrangements. We would be happy to participate in the proposed working group.

We anticipate that the main benefits of common charging methodologies would be:

- Greater transparency and customer understanding resulting from common terminology. These benefits will most likely be realised by developers, SLPs and NAVs that operate at a national level.
- The above benefit of improved transparency and understanding would also support competition and effective markets within the water industry.
- That differences in charges between companies would become mainly the result of cost differences, not methodological differences, increasing confidence in comparability of charges and strengthening the incentive properties of comparative competition.

The main drawbacks we anticipate are that:

- By focusing on common terminology which benefits developers, SLPs and NAVs at a national level, there is a risk of alienating smaller, more regional developer customers, including one-off customers.
- Having invested time and resources to develop and settle on a common industry methodology, there may be weaker incentives to deviate from the common methodology in future, for example in response to innovation,
- Common methodologies may not be able to be developed for jobs where upfront fixed charges are not appropriate and are costed by exception, where bespoke charges apply based on costs incurred.
- To allow co-operation in charging methodologies, we consider that satisfactory safeguards need to be developed regarding Competition Act compliance, and while there is evidence in other sectors that this barrier has been overcome, this is not necessarily a guarantee that the same can be done in the water sector. We do, however, acknowledge Ofwat’s commitment to reviewing all necessary safeguards and welcome this in order to provide appropriate assurance.

With regards to the adoption of common methodologies, our approach will be informed by the output of any working group set up to finalise defined terminologies. However, Affinity Water supports the principle of industry collaboration in the area of new connections across the industry and we think it would be valuable to proceed with a New Connection Charges Working Group to develop the approach and further define and agree the scope in this area.

Q8: Do you agree with the high-level scope of the proposed New Connection Charges working group? Please tell us your views on the proposed working group, including whether Ofwat should make the work mandatory, for example through a change to our new connection rules.

We are content with the proposed high-level scope and, as noted above, request that satisfactory safeguards are put in place to mitigate any potential competition law risks. This is particularly salient when taking into consideration “demonstrate clearly whether contractors’ rates reflect actual costs incurred by them in the provision of each service” as an element of scope. We would expect this scope to be further detailed by the working group before formal agreement across the industry.

Affinity Water would be more comfortable participating in this work if it were explicitly recorded as a requirement within the new connection charging rules. While there may be consideration as to whether a specific licence condition would better provide the necessary safeguards, we are mindful that a licence modification could result in a lengthy and work intensive process. Therefore, in our view, an amendment to the rules would be preferable to a licence modification.

Appendix 1

We have reviewed the current and proposed (highlighted in grey boxes) definitions listed in the Consultation document and provided feedback against each definition. A number the definitions listed are either already in use, or we have a very similar definition, in our existing charging arrangements for new connection services 2020/21 document. Where we believe a definition could be varied from the proposed wording, we have provided suggested wording for consideration.

| Term | Definition | Affinity Water Comments |
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| <i>Alternative point of connection</i> | <i>means a location on our water or sewerage network other than the point of connection.</i> | <i>We would suggest a slightly varied definition: means a variation connection point to our existing water or sewerage network to support your development(s) supply requirements.</i> |
| <i>Carriageway</i> | <i>means tarmac covered ground.</i> | <i>We would suggest a slightly varied definition: means a width of road intended for vehicles rather than pedestrians.</i> |
| Charging Arrangements | means a document setting out the charges and/or the methodologies for calculating them those, applied by the water or sewerage undertaker in accordance with these rules. | We currently use this definition in our 2020/21 charging arrangements document. |
| Charging Rules | means the Charging Rules for New Connection Services (English Undertakers) issued under sections 51CD, 105ZF and 144ZA of the Act. | We use a similar definition in our 2020/21 charging arrangements document and would be happy to update our definition table in the future to reflect this wording. |
| Charging Year | means a calendar year running from 1 April in a given year to 31 March in the following year. | We currently use this definition in our 2020/21 charging arrangements document. |
| Charges Scheme Rules | means the Charges Scheme Rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991. | We currently use this definition in our 2020/21 charging arrangements document. |
| 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. It consists of a pipe laid from an existing or newly laid Water Main to the boundary of a property, including a meter housing and stop valve. | We currently use this definition in our 2020/21 charging arrangements document. |
| Connection Charges | means 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). | We use a similar definition in our 2020/21 charging arrangements document and would be happy to update our definition table in the future to reflect this wording. |
| Contestable Work | refers to work or services that can be completed by either the relevant undertaker or persons other than the relevant undertaker. | We use a similar definition in our 2020/21 charging arrangements document and would be happy to update our definition table in the future to reflect this wording. |
| Developer | means any person or business which is responsible for a Development. | We currently use this definition in our 2020/21 charging arrangements document. |

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| 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. | We currently use this definition in our 2020/21 charging arrangements document. |
| Diversion Charges | means the charges imposed by that undertaker pursuant to section 185(5) of the Water Industry Act 1991. | We use a similar definition in our 2020/21 charging arrangements document and would be happy to update our definition table in the future to reflect this wording. |
| Domestic premises | means any premises used wholly or partly as a dwelling or intended for such use. | We would suggest a slightly varied definition: means a dwelling which will be used as a place of permanent or semi-permanent residence. An example of this would be a house or a flat. |
| Existing main | means a main that was in operation before development commenced. | We are happy to adopt this definition. |
| Fixed Charges | means 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). | We use a similar definition in our 2020/21 charging arrangements document and would be happy to update our definition table in the future to reflect this wording. |
| Footpath (Footway) | means a concrete covered surface. | We would suggest a slightly varied definition: means a type of thoroughfare that is intended for use by pedestrians and not other forms traffic such as motorised vehicles. |
| House | means any building or part of a building that is occupied as a private dwelling house or which, if unoccupied, is likely to be so occupied and, accordingly, includes a flat. | Depending on the final definition version for domestic premises, we may not need to also include a definition for House. |
| 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 connected to the new Sewer, and "Income Offsetting" shall be construed accordingly. | We currently use this definition in our 2020/21 charging arrangements document. |
| Infrastructure Charge | means the charges described in section 146(2) of the Water Industry Act 1991. That is, a charge paid by the developer to the water company when a property is connected to the company's water supply or sewer for the first time which contributes to wider network | We use a similar definition in our 2020/21 charging arrangements document and would be happy to update our definition table in the future to reflect this wording. |

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| | reinforcement to meet the increased demand arising from the new connections. | |
| 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. | As a clean water only company, this is not a definition we would include in our future charging arrangements definition table. |
| Long length | refers to the length of the new water pipe required between the private supply pipe (at the property boundary) and the point of connection, where the length is 4 metres or more and can be in different surface types, e.g. 4 metres in the road, 4 metres in unmade ground. | With clear definitions for supply pipe and communication pipe, along-side clear examples of charges for customers, we would not suggest including this definition in any future definition tables as they may cause confusion for some developer services customer groups. |
| NAV | 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. | We would be happy to include this definition in our future charging arrangements definition table. |
| 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 of or a section 117E 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. | We currently use this definition in our 2020/21 charging arrangements document. |

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| New Appointee | means 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. | We would be happy to include this definition in our future charging arrangements definition table, though note that the proposed NAV definition could supersede this. |
| New Connection Services | <i>is the collective term for New Water Mains, New Sewers, Service Connections, Lateral Drains, Waste Connections and Diversions.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| No excavation | <i>These charges apply where we do not undertake any excavation, backfilling or reinstatement, for example, where the trench has been pre-excavated by you to our standards</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Non-contestable Work | means work or services that only the relevant undertaker (or an agent acting on their behalf) can do or provide. | We currently use this definition in our 2020/21 charging arrangements document. |
| On-Site | <i>works carried out or proposed to be carried out within the site boundary.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Off-Site | <i>works carried out or proposed to be carried out outside the site boundary.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Point of connection | <i>means the nearest practical location where the existing water main or sewer is the same size or larger than the new connecting main or sewer</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| 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. | As a clean water only company, this is not a definition we would include in our future charging arrangements definition table. |
| Requisition Charge | <i>means 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. That is, a charge set by the water company for the provision of the new water main or public sewer (a requisition) to recover the costs reasonably incurred in providing them.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Self-Lay | <i>the laying of water pipes and associated infrastructure in accordance with section 51a of the Act.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Self-lay provider | <i>An accredited operative who can lay the pipework for a new water main or sewer rather the infrastructure being laid by the water company. The water company will take over responsibility for self-laid pipes that meet the terms of its agreement.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Service Connection | <i>means the construction of the pipe between the supply pipe of the premises and the public water main which is provided under section 45 and 46 of the Act.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| 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 | We currently use this definition in our 2020/21 charging arrangements document. |

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| | some valve, and includes part of any service pipe. | |
| 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. | As a clean water only company, this is not a definition we would include in our future charging arrangements definition table. |
| Short length | <i>refers to the length of the new water pipe required between the private supply pipe (at the property boundary) and the point of connection, where the length is less than 4 metres.</i> | <i>With clear definitions for supply pipe and communication pipe, along-side clear examples of charges for customers, we would not suggest including this definition in any future definition tables as they may cause confusion for some developer services customer groups.</i> |
| Site Specific | 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. Charges for site specific work relate to the provision of connection structures or facilities located on a development up to the nearest practical point on the existing network where the connecting pipework is of a nominal bore internal diameter no larger than that of our existing network. They do not refer to costs or work required as part of network reinforcement. | We currently use this definition in our 2020/21 charging arrangements document. |
| Small Company | means a New Appointee. | With a clear definition for NAV we would suggest not including this definition in future definition tables. A small company can mean something different to different developer services customer groups, whereas the new appointee definition has a clear meaning. |
| Supply pipe | <i>means the part of the service pipe that is not the communication pipe.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| Undertaker | means a water undertaker or sewerage undertaker. | We currently use this definition in our 2020/21 charging arrangements document. |
| Unmade ground (verge) | <i>refers to ground which does not have a surface. For example, unmade ground may feature grass and topsoil.</i> | <i>We would be happy to include this definition in our future charging arrangements definition table.</i> |
| 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 any accessories for the pipe. | We currently use this definition in our 2020/21 charging arrangements document. |