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Charges team  
Ofwat

By email: [charging@ofwat.gov.uk](mailto:charging@ofwat.gov.uk)

24<sup>th</sup> July 2020

Dear Ofwat

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

Thank you for your consultation following your comparative analysis of new connection charging arrangement documents. We found the analysis useful, while agreeing that no specific conclusions can be drawn from it. The analysis is very similar in construction to the worked examples within our charging arrangements publication.

We set out our response to the specific questions in the consultation below:

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 agree that common terminology can help Developer Services customers understand charges. However, the practical application of this principle of a common terminology may be incorrect in assuming a standard national definition will aid understanding of charges. There is regional variation in approach that national developers will understand and local developers be familiar with. For example, in Appendix A1 you have “Footpath (Footway) means a concrete covered surface”, whereas in the Bristol Water area the surface would be 10mm Tarmac in over 90% of cases. We would suggest engaging developers in developing scenarios that they would like to be used as a comparison. In practice you may find limited commonality in terms used from the customers perspective.

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

We believe the following glossary terms require amendment:-

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“Carriageway” – means tarmac covered ground – This is too generalised as there are different types of Carriageway surfacing ranging from concrete e.g. Hot Rolled Asphalt and tarmacadam. The cost of reinstatement between these varies vastly and aiming to average could potentially disadvantage connections in the cheapest surface.

“Communication Pipe” – need to add “unless meter housing is wall mounted or internal”.

“Contestable Work” – Add “or accredited persons other than the relevant undertaker”.

“Footpath” – Add “or a tarmac covered surface that is not part of the Carriageway.

The definition of “Self-Lay” was not clear, and only applied to water pipes rather than the definition of Self-Lay Provider which also refers to sewers. Although we understand the legal distinction in terms of the Act, the mixture of water company and sewers in the definition will not necessarily add to clarity as a standard set of terms for us as a water only company.

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?”

Yes, we believe explicit expectations on the presentation of worked examples may be helpful. We have consulted our customers on the worked examples that we already use, and therefore do not particularly want to replace them with alternatives that may not add much, other than being consistent nationally. Therefore, Ofwat should consider whether developers have responded to this consultation and expressed demand for these worked examples in preference to existing presentations.

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

We did not have any particular observations, other than noting that very little can be read into the numbers at this high level – are low (high) charges efficiency (inefficiency), local cost levels, cost allocation across a mix of developments or some other factor? We do not think that a common charging methodology, on its own, would necessarily reduce the range of charges, or aid understanding of whether this was right, wrong or a function of a series of competitive markets and independent tender processes that this market largely reflects.

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

In the consultation you also mention Covid-19. This is a disruption to the housing market, with the consequences likely for a number of years. Company overhead costs remain

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(largely) fixed, due to the uncertainty of how developer demand for activity will vary. In this situation, you will be less able to read anything into data than normal. It is important therefore to focus on minimising overhead costs, which includes the cost of regulation and new requirements unless there is clear evidence of a problem and a priority from a range of developers for the solution. We would note that with D-MEX Ofwat have recently introduced a strong incentive for water companies to improve developer satisfaction. You should clearly consider whether this form of new incentive is having a positive market impact.

From our experience we do not believe your hypothesis that high SLP or NAV market penetration would result in a higher incumbent cost per job has a strong basis. With efficient market entry SLP and NAVs are entering where their innovation results in a lower cost – this does not necessarily result in a higher fixed cost on other jobs as a result. Where there is greater complexity, the developer may find lower risk to their deliver from an SLP or NAVs activity. Overheads will be recovered from SLP and NAV activities where they are cost reflective to begin with, and contract volumes should flex accordingly with the correct contracting arrangement that reflects SLP and NAV activity in the market – competitive entry benefits all customers if the market is operating effectively. Figure 3.1 in your consultation may suggest a regional and local pattern exists with lower market costs in the South West in general.

*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 agree that cost-reflectivity should be explicitly part of the general principles. Even without this being included today, because of competition requirements it is already a principle that should be applied. We do not see any evidence in your analysis which suggests the contrary when considering the industry as a whole. We therefore see no specific justification for other measures and the analysis does not provide a clear case for these. We would suggest that your role in questioning individual company charges is the approach rather than a less targeted approach.

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

We suspect that common charging methodologies could make the market less effective – it will disrupt where competition currently exists and will not necessarily benefit competition in areas where it is lower. We suggest that developers’ priorities should be considered, as the end customer. We can see that a common methodology may help Ofwat and Developer



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Services customers who work across numerous water company areas, but simplification would disadvantage some developer services customer segments. As long as it can be observed that the charges are fair and transparent and there is no demonstrable market harm or non-compliance with charging rules then common methodologies would not be required. We already have a set of charging arrangements that has grown in length by c300% in three years due to new requirements and worked examples.

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 do not agree there is sufficient evidence to develop a common charging methodology. Therefore, we do not believe it is proportionate to impose this expectation on the water sector. Water UK have no official status and resources to undertake this activity. In other sectors specific the regulator will prioritise the approach depending on the needs of market participants, and make provision for funding. We therefore suggest prioritising the overall regulatory burden and providing a clear problem statement driven by the market participants. We are not aware of strong customer support for engagement in a new working group at this stage.

A common charging methodology has been considered previously, and there have been previous new connection charges working groups of the type Ofwat envisage<sup>1</sup>. Ofwat do not reference back to the criteria set out in section 3.3.3 and 5.3 of the 2016 Ofwat consultation<sup>2</sup>. We think Ofwat need to be clearer about whether the issues set out there remain, which may be difficult to tell given the new arrangements only commenced 1 April 2020 and the analysis in the consultation is on the previous year’s charges. We see little benefit in revisiting and creating the additional burden through this route, unless Ofwat can identify with developers a general problem and process towards a solution that they support. This should not be any dissatisfaction with the overall framework that Ofwat required companies to introduce (such as infrastructure charges varying by region), or income offset being less focused on larger developments as it was previously. As the 2016 study found, there is a trade-off between simplicity, standardisation and cost-reflectivity that requires Ofwat to be very clear about what the problem is to any study group. This should build on the previous work and consider this trade-off based on clear evidence.

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<sup>1</sup> <https://www.water.org.uk/wp-content/uploads/2018/11/Connections-charging-consultation.pdf>,

<sup>2</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2016/03/pap\\_con20160324connectcharge.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2016/03/pap_con20160324connectcharge.pdf)

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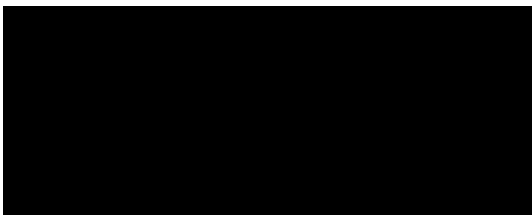
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We suggest Ofwat engage directly with developers in order to identify specific areas for targeted improvement, rather than taking another top-down approach that assumes standardisation will improve developer satisfaction. If it is clear from the consultation responses there is a wide scale interest from developers, then Ofwat's proposals may be proportionate.

Yours faithfully



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Director of Strategy and Regulation

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