

July 2020

# Consultation on bulk charges for New Appointments and Variations (NAVs)

## About this document

This document outlines current practices and consults on potential changes to how we regulate the **bulk supply or discharge charges paid by new appointees** (NAVs) to larger water companies (**incumbents**). Our consultation draws on the findings of CEPA's [study on bulk charges for NAVs in England and Wales](#).

As a result of our [May 2018 guidance](#) on bulk charges for NAVs, NAVs are now much better placed to calculate what their bulk charges would be when considering whether to bid for new sites. We are now consulting on applying best practice in the calculation of cost-reflective bulk charges, which we expect to reduce the large variation in margins that we have seen. In addition, we are consulting on how to ensure that bulk charges support better environmental outcomes associated with NAV sites.

Bulk supplies or discharges can be between incumbents or between incumbents and NAVs. This document relates to bulk supply or discharge agreements between incumbents and NAVs, not between incumbents.

Because the NAV framework applies to both England and Wales, this consultation relates to incumbents wholly or mainly in England (**English incumbents**) and incumbents wholly or mainly in Wales (**Welsh incumbents**).

## Responding to this consultation

**We welcome responses to our questions and comments on the CEPA study by 7 September 2020.**

Please send your response by email to [NAVpolicy@ofwat.gov.uk](mailto:NAVpolicy@ofwat.gov.uk). Due to office closure during the Covid-19 pandemic, we are unable to receive responses by post.

We may publish responses to this consultation on our website, unless you state that you would like your response to remain unpublished.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 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 Background

A well-functioning NAV market can deliver for customers in terms of increased choice, efficiency and innovation.

The NAV framework is consistent with our wider approach to promoting the targeted use of markets to benefit customers. Within this context, we continue to develop our thinking, particularly relating to bulk charges given its key importance to the effective operation of the new connections market.

Following a [report by Frontier Economics into the NAV market](#) and a [consultation](#) in November 2017, we published [guidance on bulk charges for NAVs](#) in May 2018 (**our 2018 guidance**). It set out how we would approach future requests to determine the bulk charges paid by NAVs to incumbents. We also said that incumbents should publish their bulk supply tariffs in line with the guidance.

### 1.2 Legal framework

#### 1.2.1 Bulk agreement disputes

Where parties are unable to agree a bulk supply or discharge agreement, we can be asked by either party to determine the terms (including the price) of the bulk supply or discharge under sections 40, 40A, 110A and 110B of the Water Industry Act 1991.

Our 2018 guidance sets out the methodological approach we intend to use when asked to determine the price elements of bulk supply or discharge agreements. It also facilitated incumbents to have regard to the guidance when setting their charges in the first place.

We also have concurrent powers with the Competition and Markets Authority (**CMA**) to apply competition law with respect to water and wastewater activities in England and Wales. Where appropriate, we can use our powers in relation to existing markets for bulk supplies to ensure they are working for the benefit of all customers.

## 1.2.2 Charging rules

Changes to the Water Industry Act 1991 by the Water Act 2014 enable us to issue charging rules with respect to bulk supplies and discharges. Currently, these provisions are in force in relation to agreements between English companies (since 1 April 2018) and between Welsh companies (since 1 April 2019).

Introducing charging rules would change the framework for how we regulate bulk agreements between incumbents and NAVs. Instead of resolving disputes after NAVs and incumbents have exhausted efforts to negotiate acceptable bulk agreements (including the price and non-price terms) we would set rules for how incumbents should set their charges, enabling us to enforce any breaches of those rules and to direct incumbents to alter their practices under provisions in each incumbent's licence (or 'instrument of appointment').

However, our determination powers under sections 40, 40A, 110A and 110B of the Water Industry Act would remain, meaning disputes could still be referred to us should both parties fail to agree. While we would expect the introduction of bulk supply charging rules to reduce the extent of requests for determinations on bulk charges, we would still be able to resolve disputes on price and/or non-price terms.

When developing any charging rules, we must have regard to guidance issued by the UK and Welsh Governments. Guidance relating to overall charging principles as well as bulk charges have been issued by the UK Government (see [2016](#) and [2018 guidance](#)) and the Welsh Government (see [2017 guidance](#)).

## 1.3 Our 2018 bulk charges guidance

Our 2018 guidance said that bulk charges to NAVs should be based on a 'wholesale minus' approach for each site. This approach starts with the relevant wholesale tariff that would be paid by end customers to the incumbent, and deducts costs that the incumbent would no longer incur if a NAV supplied the site instead.

### Avoided costs

As shown in figure 1, in our 2018 guidance we categorised the costs avoided by the incumbent due to NAV entry as being:

- the ongoing costs of operating and maintaining on-site assets;
- a wholesale allowed return on capital invested in on-site assets<sup>1</sup>; or

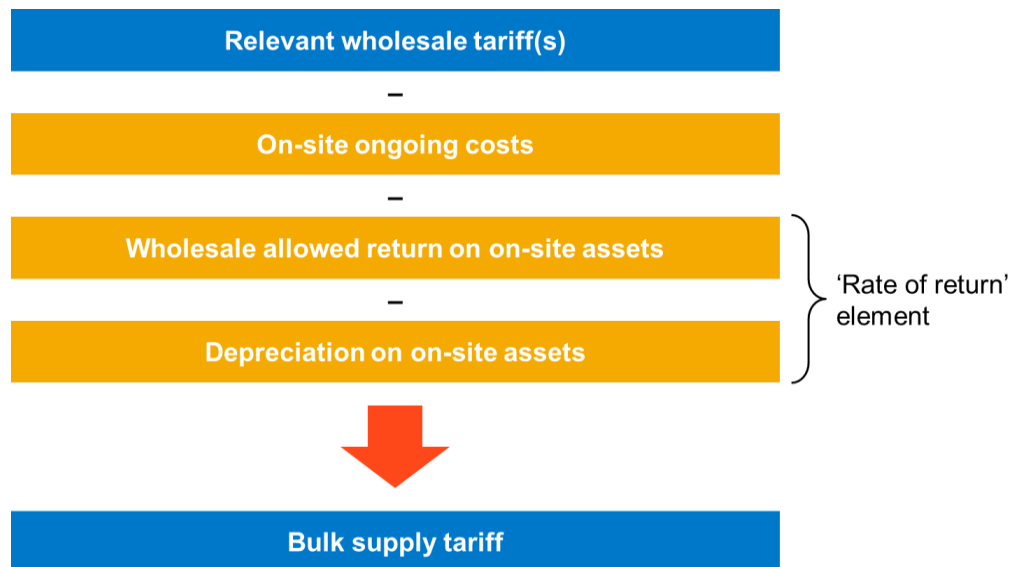
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<sup>1</sup> Previously referred to as the 'WACC on on-site assets' element in our 2018 guidance.

- depreciation on the on-site assets.

For simplicity, we collectively refer to the wholesale allowed return and depreciation elements as the ‘rate of return element’ in this document.

**Figure 1 – 2018 guidance on bulk charges**



For the on-site ongoing costs, we said estimates should reflect the incumbent’s costs, and account for the level, timing and profile of all costs incurred over the lifetime of the on-site assets. While we did not prescribe which types of costs should be included, we said an allowance should be made for on-site leakage.

We said the rate of return elements only apply to the extent that the incumbent would have accrued the on-site assets to its regulatory capital value (RCV). We also considered that the incumbent’s wholesale allowed return, as determined in our price reviews, should be adjusted to reflect both the relatively lower regulatory protection experienced by NAVs and the relevant risks for on-site activities. We set out a detailed methodology for estimating an adjusted wholesale allowed return.

### **Excluded costs**

We specified that costs recovered from developers and offsite costs should not be factored into estimating bulk charges for NAVs.

### **Publishing tariff information**

We said we expected incumbents to publish tariff information and to promptly adjust their charges to reflect any material changes, for example when inputs change.

## 1.4 Recent developments

On 28 May 2019, our chief executive Rachel Fletcher [wrote to incumbent water companies](#) about the development of effective markets and the overall level of support for markets by incumbents, inviting responses from industry. We delayed publishing our findings so that members of the industry could focus on issues arising as a result of the Covid-19 pandemic, but will do so in the next few months.

Most incumbents have published bulk charges for NAVs based on our May 2018 guidance. As part of our commitment in Rachel Fletcher's letter to review the state of all markets for the supply of water and sewerage services in England and Wales, we appointed consultants CEPA to review current practices by incumbents in setting their bulk charges for NAVs and to suggest potential improvements to our 2018 guidance.

[Changes to the 'income offset'](#) in our new connections charging rules for English water companies came into effect from 1 April 2020. As a consequence, developer customers of English companies now fully fund the construction of on-site assets. The income offset still applies to on-site assets for Welsh companies.

Since preparing our 2018 guidance, the industry has established new guidance on asset adoption. We have approved the [sewerage asset adoption guidance](#), while the [water asset adoption guidance](#) is currently still pending. It is important that the bulk charges cost methodology is consistent with asset adoption guidance, for example to ensure a level playing field between NAVs and self-lay providers (SLPs).

In May 2020 we published a [consultation](#) presenting our analysis of new connection charges for English incumbents. We are seeking views by 16 September 2020 on the nature and cause of the inconsistencies in incumbents' new connection charging arrangements, and our proposed way forward under an industry-led working group. The issues overlap with those discussed in this consultation, particularly around consistency of approach.

## 1.5 Structure of this document

This rest of this document is structured as follows:

- CEPA's findings on the current practices of incumbents (section 2);
- opportunities to develop our policy approach (section 3);
- how we propose to implement these changes (section 4); and
- our next steps (section 5).



We are publishing CEPA's report, '[Bulk Charges for New Appointments and Variations \(NAV\) Regime in the Water Industry in England and Wales](#)', alongside this consultation.

## **2. Review of current practices**

In this section we summarise CEPA's findings on incumbents' current practices when setting bulk charges for NAVs. Incumbents should consider the detailed compliance points raised by CEPA when setting bulk charges.

We commissioned CEPA to:

- help us more accurately understand what incumbents' current NAV bulk charging practices are and whether incumbents are following our 2018 guidance; and
- provide a basis for further development of our 2018 guidance or potentially establish rules to ensure that NAV bulk charges are consistent with ensuring a level playing field for NAVs.

In its report, CEPA evaluates how incumbents have implemented our 2018 guidance in 2019-20, using publicly available information as well as information provided by incumbents in response to a request for information (RFI) from us.

### **2.1 Summary of CEPA's findings**

With respect to publishing tariffs and applying the wholesale minus approach when setting bulk charges, overall, CEPA finds a good level of compliance. CEPA finds it difficult to understand how charges were calculated on the basis of published information alone.

Key observations made by CEPA are set out below. These observations are based on practices in late 2019. Some incumbents have since published revised charges and associated calculations.

#### **2.1.1 Availability of tariff information**

CEPA considers that for most areas of England and Wales, prospective NAVs should be able to estimate the bulk charges that would apply if they sought to serve a site. However, by the end of 2019, not every incumbent had published their bulk tariffs for NAVs and some published tariffs were outdated.

Given that we published our guidance in May 2018 after an extended consultation period, we would have expected incumbents to have published bulk charges in a timelier manner.

Should we make further refinements in the future, we would expect a more timely response from all incumbents. We are minded to publish indicative timescales for implementation of revised NAV tariffs, which should allow NAVs to more effectively participate in the new connections market.

Some incumbents published 'tariff calculators' which CEPA noted could help NAVs to estimate their bulk charges. We welcome any approach which encourages transparency and helps NAVs better estimate their likely bulk charges. Care must be taken to ensure that such tools are accurate and quality assured. Worked examples are also useful.

Most published tariffs applied to 'standard NAVs' which CEPA interprets as sites without specific operational characteristics, for example without on-site pumping stations or sewage treatment. We support the publication of non-standard elements that may form aspects of bespoke tariffs. We consider that this transparency would enable prospective NAVs to make more informed decisions about entering different parts of the market, including the provision of innovative on-site services.

### **2.1.2 Calculation transparency**

CEPA finds that there is often less clarity around how incumbents calculate deductions for avoided costs. Incumbents tended to publish limited information on how they estimated costs and the underlying assumptions and rationale used for why certain costs were included or excluded.

CEPA notes that the detailed calculations and assumptions as well as the rationale for which activities and costs are avoided by incumbents due to NAV entry are central to the application of the wholesale minus approach. It considers that further transparency is needed. This would both enable NAVs to properly scrutinise and, if necessary, challenge incumbents on their bulk charges during negotiations, and us in monitoring the implementation of our guidance.

### **2.1.3 Application of the wholesale minus approach**

Based on publicly available information regarding the methodologies used to calculate NAV tariffs, CEPA finds that the 16 of 17 incumbents that published NAV tariffs in 2019-20 adopted the wholesale minus approach set out in our 2018 guidance. The remaining company has done so for 2020-21.

One incumbent applied a supplementary 'large user' charge to NAVs. While this is not compatible with the wholesale minus approach, the incumbent concerned no longer levies this charge.

CEPA finds that incumbents adopt a wide range of approaches and assumptions when setting their bulk charges. It observes a wide variation in NAVs' estimated wholesale operating margins for a notional site. Because the differences are not explained by incumbents' cost characteristics alone, they are likely to be driven by how different estimation approaches have been applied.

### 3. Opportunities to develop our policy approach

In this section we consider some of the issues that CEPA raises and set out how we propose to address them. We also welcome views from stakeholders on other relevant issues in our 2018 guidance.

While we consider it would be overly prescriptive to incorporate all aspects of CEPA's methodological approach into our guidance, its report provides examples of good practice that incumbents may wish to apply to their charging practices.

As CEPA's review identifies, the wide range of approaches and assumptions used by incumbents leads to a high variation in the estimated wholesale operating margins available to prospective NAVs. While this may be partly explained by underlying cost differences in each incumbent's area, we are concerned that the range of different approaches used by incumbents may be a significant factor.

We consider the following issues in turn:

- the **relevant starting point** – including the use of weighted average tariffs and large user tariffs;
- **avoided cost estimation** – including overall cost estimation approaches, the treatment of indirect costs and capital maintenance expenditure;
- the **rate of return element** – including the impact of changes to the income offset and whether an additional allowance is appropriate; and
- how **environmental impacts** could be accounted for in bulk charges for NAVs.

#### 3.1 Relevant starting point

##### 3.1.1 Weighted average tariffs

###### What we said in our 2018 guidance

Using a 'wholesale minus' approach requires incumbents to define the relevant wholesale tariffs to use as a starting point. They should reflect the mixture of residential and business end consumers that are served on the site.

We said incumbents can either set out an *ex ante* 'overall weighted average' tariff that reflects the typical composition of a new development, or set out the 'menu items' that would be applied to specific sites.

## **CEPA's findings**

Almost all companies have used the latter approach which is more accurate, although the *ex ante* approach is simpler to administer by NAVs. CEPA says it may be appropriate to maintain this flexibility, but provide for NAVs to request bespoke tariffs if a site's customers differ significantly from the weighted average.

## **Our view**

A menu-based approach that reflects the actual mix of properties on a site would be more accurate and facilitate greater transparency, for example regarding water efficiency on the site. We do not consider it would be overly burdensome to operate because it is already standard practice.

For these reasons we expect incumbents to use a menu-based approach when defining the relevant wholesale tariffs.

**Q1:** Do you agree with our proposed approach to weighted average tariffs?

## **3.1.2 Large user tariffs**

### **What we said in our 2018 guidance**

In case of a dispute we said we will apply a wholesale minus approach.

## **CEPA's findings**

CEPA notes that some incumbents are giving NAVs the option of choosing between a wholesale minus approach and a larger user tariff.

## **Our view**

When we assess applications for new sites, we observe that 'large user tariffs' are often being selected by NAVs where they are offered by incumbents. That is often the case irrespective of the criterion used for the application (i.e. consent, large user or unserved) which suggests they are not being calculated on a cost reflective basis, and hence may encourage inefficient entry.

As such, now that the guidance has been in place for more than two years, we consider that for new sites, incumbents should only offer bulk charges for NAVs based on a wholesale minus approach. The wholesale minus approach should apply to NAVs appointed under any criteria, with due regard to the relevant avoided costs. We are interested in views on the approach for existing NAV sites.

**Q2:** Do you agree that large user tariffs should not be offered for new NAV sites? What should the approach be to existing sites?

## 3.2 Avoided costs

### 3.2.1 Cost estimation approaches

#### What we said in our 2018 guidance

We said incumbents should deduct the ongoing costs of operating and maintaining on-site assets from their relevant wholesale tariffs. We said the deductions should be based on the incumbent's costs and that historical costs could be a reasonable proxy.

We did not explicitly define the nature of costs (i.e. whether they were direct or indirect) and did not specify how incumbents should estimate this.

#### CEPA's findings

CEPA finds incumbents use a range of approaches, with the following broad types:

- **'top-down' approaches** – which use company-level data to derive unit costs for last-mile infrastructure;
- **'middle-down' approaches<sup>2</sup>** – which use company-level data for different activities identified as avoided and allocating them to the on-site network; or
- **'bottom-up' approaches** – which use specific estimates of typical costs incurred for different activities identified as avoided.

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<sup>2</sup> In its report, CEPA refer to these approaches as 'middle-up'.

CEPA considers there is no single preferred approach, but notes that bottom-up approaches are more cost reflective, but can be less transparent than more top-down or middle-down approaches.

CEPA also provides a common list of direct avoided ongoing operating costs which it considers incumbents should use to demonstrate whether they have included or excluded these costs from their bulk charges.<sup>3</sup>

### **Our view**

There is a trade-off between more consistent, transparent and less burdensome top-down approaches and more cost reflective, subjective bottom-up approaches.

A key drawback of top-down approaches is that they are unlikely to reflect the actual costs of operating last-mile infrastructure. For example, CEPA finds that they tend to include wider network costs and have poor cost reflectivity.

In contrast, bottom-up approaches tend to be more cost reflective, but can be less transparent to stakeholders. We do not expect bottom-up approaches to be burdensome to administer because incumbents should already have detailed cost information on their on-site asset management.

For this reason, we are minded to prefer bottom-up approaches when estimating avoided costs.

An alternative approach would be to apply 'middle-down' approaches through more granular cost segmentation in the annual performance reports. This would be more transparent and would help to ensure that costs only reflect last-mile infrastructure rather than other upstream costs, but it is likely to be less cost reflective than more bottom-up approaches.

**Q3:** Do you agree that incumbents should use bottom-up approaches to estimate costs, or would more granular accounting segmentation be more appropriate?

**Q4:** Do you agree with CEPA's list of common avoided costs or should additional items be included? Should we incorporate this list in our guidance?

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<sup>3</sup> See appendix B of CEPA's report.



### **3.2.2 Treatment of indirect costs**

#### **What we said in our 2018 guidance**

We did not specify how indirect costs should be treated in our 2018 guidance. Indirect costs are those costs that cannot be directly attributed to the provision of a single service.

#### **CEPA's findings**

CEPA finds that incumbents use a range of approaches to treat indirect costs. Some incumbents do not include any indirect costs in their estimation of avoided costs, while some explicitly account for them. Those incumbents that use top-down approaches to cost estimation are likely to include an element of indirect costs.

CEPA notes that a larger deduction for indirect costs could be made to encourage greater entry by NAVs.

#### **Our view**

When estimating avoided costs, incumbents should take account of common costs avoided as a result of NAV entry. In line with the treatment of direct costs, these estimates should be based on the incumbent's avoided costs.

**Q5:** Do you agree with our proposed treatment of indirect costs?

### **3.2.3 Capital maintenance expenditure**

#### **What we said in our 2018 guidance**

We noted that new assets are initially less likely to require the same level of maintenance as older assets, and that maintenance costs should rise over time. We suggested that incumbents should consider the level, timing and profile of all costs over the lifetime of an asset and estimate an equivalent annuity.

## CEPA's findings

CEPA finds significant differences in how incumbents have estimated capital maintenance and replacement costs. Some make an explicit deduction for the need to replace assets over time, while for others it is unclear.

CEPA notes that incumbents can adopt top-down, middle-down or bottom-up approaches to estimate capital maintenance expenditure.

## Our view

In line with our view set out in section 3.2.1, we consider incumbents should use a bottom-up approach to estimate capital maintenance and replacement expenditure. We note that costs are likely to vary over time, and as such incumbents should consider how best to estimate this, including the use of an average annuity.

Under new [sewerage asset adoption arrangements](#), the developer is responsible for maintenance of the assets for one year after they are provisionally certified. Similarly, although arrangements are not yet finalised, it is proposed that the SLP would remain responsible for the costs of rectifying defects for one year after the adoption date of water assets. Our interpretation of this is that the incumbent has (close to) no avoided capital maintenance costs for the first year of a new NAV site.

**Q6:** Do you agree with our proposed approach to capital maintenance and replacement expenditure?

## 3.3 Rate of return element

### What we said in our 2018 guidance

We said that incumbents should deduct an appropriate level of return on on-site assets, and depreciation of the on-site assets, to reflect the financing costs that incumbents have avoided due to NAV entry. We collectively refer to these as the 'rate of return' element in this document.

We set out a detailed methodology for how to adjust the incumbent's wholesale allowed return on capital to reflect the different regulatory protection and risk exposure experienced by NAVs. We said this adjusted return should be applied to the value of assets that would have been added to the RCV if it served the site.

## CEPA's findings

CEPA notes that with changes to the income offset for English incumbents from 1 April 2020 which mean incumbents' on-site assets are funded by developers, and if maintenance costs are incorporated into the avoided ongoing costs element, the rate of return element will no longer apply to these incumbents.

CEPA also suggests an additional allowance could be made to ensure a NAV that is equally efficient is able to earn a profit margin, and to reflect wholesale operating risks to which it is exposed. In the case that an additional deduction is required, CEPA presents a number of estimation approaches that could be used, with no preferred option.

## Our view

We note that changes to the income offset for English incumbents mean that developers now fully fund the cost of on-site assets. For this reason, English incumbents should no longer include a deduction through the rate of return element because these costs are no longer avoided by the incumbent.

However, changes to the income offset do not apply to Welsh incumbents and as such developers only partially fund on-site assets, although this may change in future. Therefore for Welsh incumbents, the rate of return element is likely to remain relevant where the income offset would otherwise apply to on-site assets.

We also note that our 2018 guidance sets out a detailed methodology for estimating an appropriate return. Given the changes, we welcome views from stakeholders on whether our guidance should be less prescriptive in this area.

In terms of an additional allowance, we think that in principle, this should reflect the operational risk experienced by NAVs to operate on-site assets which the incumbent has avoided.

**Q7:** Do you agree with our proposed approach to the income offset for Welsh incumbents?

**Q8:** Do you have other comments on the rate of return with respect to English incumbents?

## 3.4 Environmental impacts

### What we said in our 2018 guidance

We consider the environment to be an important part of our charging framework, and how incumbents set their charges can have an important role in driving environmental improvements. In our [2019 strategy](#) we said we would make the environment integral to all that we do, and given the importance placed on the environment by the UK and Welsh Governments in their charging guidance to us, we consider that incumbents should provide greater transparency to their customers and other stakeholders on how their charges help achieve environmental goals.

While we did not specifically address environmental impacts in our 2018 guidance on bulk charges for NAVs, we have considered them in our frameworks for determining previous disputes.

### CEPA's findings

CEPA suggests there may be benefits in using bulk charges to reflect the environmental impacts of NAVs.

Incumbents could incentivise NAVs to make more water efficient decisions, for example by encouraging lower consumption by NAVs through their tariff structures or providing further deductions that reflect avoided upstream costs.

### Our view

We note that how incumbents structure their bulk supply charges may create perverse incentives on NAVs to increase water consumption. This is because NAVs' charges to their customers are structured by the volume of water supplied (e.g. £ per m<sup>3</sup>). If a NAV's costs do not increase by the volume of water to the same extent, then a NAV would be financially penalised if it encouraged water efficiency. We consider this to be a poor incentive and are therefore considering being more prescriptive.

Lower consumption on NAV sites should improve incumbents' supply-demand balances, enhancing their resilience and providing further benefits to customers and the environment through reduced upstream costs. Similarly, NAVs that provide on-site sustainable drainage systems should increase the resilience of incumbents' wastewater assets, thereby reducing the risk of pollution incidents and flooding.

We are interested in stakeholders' views on how incentives to promote greater water efficiency and improve environmental outcomes could be practically reflected in bulk

charges for NAVs, while having regard to NAVs with different business models such as full-serve NAVs. This would be similar to providing discounts to developers for building more water efficient homes, but may be more effective if the incentives apply on an ongoing basis.

**Q9:** Should our guidance explicitly state that bulk charges should not financially penalise NAVs for promoting greater water efficiency?

**Q10:** Do you agree with the principle that NAVs should have discounted charges if they deliver sustained lower per capita consumption (and similarly improved outcomes with respect to rainwater volumes and sustainable drainage) based on avoided costs or environmental impact mitigated?

**Q11:** Do you have other comments you wish to make regarding the methodological issues set out in CEPA's report?

## 4. Implementing changes

We are considering four potential ways to support improvements in industry practice with respect to bulk charges for NAVs. These are:

- incumbents to review the CEPA report and consider its findings;
- an industry-led approach;
- refining our 2018 guidance; and
- introducing charging rules.

We discuss each of these in turn. We then set out our proposed approach.

### 4.1 Incumbents reviewing the CEPA report

The CEPA report provides detailed expert analysis of bulk charges for NAVs, and highlights best practice. While we consider it would be overly prescriptive and inflexible for us to apply the methodology CEPA has developed in full, either in published guidance or in rules, it would be sensible for incumbents to review the CEPA report, highlight to us any concerns they may have regarding its methodology, and use the report to help them improve their bulk charges for NAVs.

### 4.2 Industry-led improvements

In its report, CEPA discusses different approaches to ensuring greater consistency across incumbents, including an industry-led process, with our input, to consider the most effective way to collect relevant information for setting bulk charges and to consistently allocate costs to last-mile infrastructure. We are currently [consulting](#) on an industry-led approach in relation to new connection charges.

Following the publication of the Frontier report in 2017 and our [summary of findings and next steps](#), Water UK conducted the NAV market behaviour improvements project, chaired by a representative from South East Water and with some substantive inputs from representatives of other companies. The project developed initiatives to tackle perceived behavioural barriers faced by NAVs, as identified in the Frontier report. We note in particular that Anglian Water has recently concluded work developing a standard template bulk supply/discharge contract for the project. In addition, a Water UK group developed metrics to measure the levels of service provided to NAVs, which complements our introduction of the developer services measure of experience (D-MeX) in the [2019 price review](#) (PR19).

We consider this project has been successful in delivering some key tools for incumbents to use to improve their support for the NAV market, but we note that there is still further work to be done to support NAVs, for example the project scope did not include issues for full-serve NAVs. We consider it provides a useful model for other industry-led initiatives, including potentially considering aspects of bulk charges for NAVs, for example to incentivise better environmental outcomes.

### **4.3 Refining our guidance**

We recognise the considerable effort of the majority of incumbents to implement our 2018 guidance and develop a new approach to setting bulk charges for NAVs.

By revising our guidance, we can build on recent progress made by incumbents in developing their charges using the wholesale minus approach, while addressing areas where we can drive further improvements in how it has been implemented in the sector.

### **4.4 Developing charging rules**

As set out in section 1.2, the Water Industry Act 1991 as amended by the Water Act 2014 enables us to issue charging rules with respect to bulk supplies and discharges.

Unlike the current framework, where we can only determine charges if parties fail to agree, introducing charging rules would require incumbents to set their bulk charges for NAVs in line with our rules.

Introducing charging rules would help to ensure that incumbents follow our wholesale minus approach leading to greater consistency across the sector and could be more proportionate for certain circumstances. However, in this case we consider it appropriate to allow some flexibility for incumbents and NAVs to agree on the arrangements for particular sites without us being overly prescriptive on how to achieve this. In addition, as most incumbents have set their charges based on our existing guidance, the added value of rules is unclear at this stage.

## 4.5 Our proposed approach

Given that companies have published bulk charges largely consistent with our guidance, we do not consider it a priority to develop rules at this stage. Instead, we propose to update our guidance as set out in section 3.

At the same time, we think that it is important that incumbents review the findings of the CEPA report and its relevance to their bulk charges.

We also think that the NAV market improvement project has illustrated the considerable merit in an industry-led approach to delivering improvements, while managing competition issues. We will discuss this further when we publish the findings of our review into incumbents' support for markets in the next few months.

**Q12:** What are your views on how changes to bulk charges for NAVs might best be implemented?



## **5. Next steps**

We welcome views from stakeholders on the questions raised in this consultation by 7 September 2020.

Once we have considered these views, we may decide to amend our guidance on bulk charges. If we do so, we will consult on revised guidance later in 2020. We intend to finalise any changes by December 2020, to enable incumbents to revise their bulk charges for NAVs in early 2021.

Ofwat (The Water Services Regulation Authority)  
is a non-ministerial government department.  
We regulate the water sector in England and Wales.

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