

November 2020

Charging arrangements for new connection services for English companies – comparative analysis and consultation – Conclusions

Executive Summary

In [May 2020 we consulted](#) on analysis we had carried out on English companies' charging arrangements for new connection services. We wanted to better understand the nature and cause of the inconsistencies in how companies were implementing our [Charging Rules for New Connection Services \(English Undertakers\)](#), in the light of feedback we had received from stakeholders. We were concerned that the inconsistencies might undermine key principles of our rules, including that the charges are predictable, transparent and fair. We also proposed some next steps to address the issues raised.

This report sets out how we have considered the responses we received and what our next steps are. We have also published all responses in full [on our website](#). We are grateful to all respondents for their comments, insights and challenges. We have carefully considered the points made and, where appropriate, amended our proposed way forward.

Respondents' views

Overall, responses showed:

- Companies and other stakeholders strongly support further commonality in terminology for connection services, and there is widespread agreement that this proposal should be implemented by changes to our charging rules.
- There is strong support among companies and stakeholders for the greater use of worked examples by companies, with more consistency between companies in how they present them. Respondents agreed that we should set clearer expectations in our [charging information notice](#).
- All respondents commented on our analysis of why charges may vary between companies. Some also suggested issues for further study, including considering off-site costs, traffic management costs, methods of cost allocation and regional factors.
- All respondents are in favour of cost-reflectivity of charges, but some questioned whether an explicit principle in the charging rules requiring cost-reflectivity was necessary or desirable, especially if it included contractor rates.
- Views on companies adopting a common charging methodology were mixed, with the majority of respondents were neither in favour nor against. Most respondents commented on the benefits and disbenefits of a common charging methodology.
- Just over half of respondents supported the idea of a working group to promote a common charging methodology. Just under half gave no clear view in favour or

against, but commented on the merits and complexities of common methodologies, the timing of any common work and which stakeholders should be represented on the group. One company was against the principle of a working group, and one consultant thought it was unnecessary.

- Most respondents were concerned about the risk of infringing competition law by working together. However, views ranged in how the risk could be managed. For example, one company said it would not take part in a working group unless Ofwat mandated it. Another company said the risk is for companies to manage. Most respondents were in favour of some form of requirement to collaborate, to mitigate the risk.

Next steps

This document sets out how we intend to take this work forward. We see two substantive workstreams at this stage.

First, we welcome the sector's enthusiasm to promote greater commonality in terminology for connection services and the better use of worked examples. We believe substantial progress can be made in time to be reflected in 2022-23 charges. Constructive collaboration across the sector will be key to success, and we are pleased certain companies have already approached us with a view to taking a substantial role in bringing the sector together, demonstrating the leadership qualities we noted in our [Review of incumbent company support for effective markets](#). There is opportunity for others to do the same. We think a working group would provide a suitable environment for joint working. And while we look to the sector experts to lead, we are also willing to facilitate the work, by contributing to the working group framework so that all stakeholders can operate productively.

Second, we remain concerned that variation between companies' charges may, at least in part, be due to endogenous factors (such as the allocation of costs, recovery of overheads and cost-reflectivity of contractors' rates). We want to address this concern and intend to carry out further analysis of companies' published costs and charges. We would welcome companies' support as we take this work forward.

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1. Consultation responses

We received 21 responses to our [May consultation](#) on charging arrangements for new connection services for English companies. They were from:

- 15 water companies;
- Independent Water Networks, a new appointee (NAV);
- Water UK;
- Fair Water Connections, an association that supports self-lay providers (SLPs);
- Consumer Council for Water (CCW), the statutory consumer body for the water industry in England and Wales; and
- Three consultants (two of whom submitted a joint response).

A full list of respondents is given in Appendix 1. We have published responses to the consultation [here](#). In sections 1.1 to 1.8 we summarise the responses to each question in our consultation paper and our views on next steps.

We do not mention every comment made but focus on broad themes, significant minority views and individual points of significance or note.

1.1 Responses to question 1

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?

1.1.1 Summary of responses to question 1

All respondents¹ were in principle in favour of increasing commonality in terminology, with benefits including reduced administrative burden, charges that are more accessible and improved interactions with developers. Some commented that

¹ Most respondents replied to all questions; only Water UK (replying to questions 7-8), an independent consultant (general response) and WA Consultancy / Technical Development Services (questions 1-3) provided partial responses. For clarity, where we use the term 'all respondents', we refer only to those who answered that question.

increasing common terminology would be of more help to developers that work across company boundaries than to single-company developers. Bristol Water commented that local variations in the use of some terms may mean full commonality is neither practicable nor desirable.

Respondents were broadly in favour of implementing our proposal by amending the list of terms in our guidance. Some highlighted areas of concern:

- Affinity Water said that it would have some concerns over sharing sensitive information (while acknowledging the risk would be low if work is focused on terminology and presentation) and requested assurances that competition risks would be mitigated appropriately.
- South Staffs Water said it would want to understand how collaboration to harmonise terminology would work in practice before it could comment further.
- Similarly, Yorkshire Water commented that it would like clarity over who would own the glossary of terminology.
- CCW suggested that Ofwat would need to ensure its prescribed definitions are consistent with those already in use at a national level.
- A few cautioned that change might confuse customers and hence the transition needs managing.
- Some suggested greater alignment with existing terms, standards and definitions. Anglian Water said terms should be chosen based on who benefits most from greater commonality and Bristol Water said we should ask developers what would help them.
- Anglian Water made the point that in its area customers use online information more than human interaction for their first communications and that diagrams help customers understand the process. It suggested any approach to harmonising terms should also allow companies to use diagrams.

United Utilities cautioned that standardisation of terminology could, in some cases, extend to the structure of charges which, as they are currently supported by each company's Board, could impair company Boards' responsibility. Although, United Utilities considers that there might be some scope to use voluntary measures to create more standardisation. It also explained that consideration must be given to how common terminology could have an impact on existing contracts.

1.1.2 Our view

There is strong support for our proposal to increase commonality in terminology and to implement agreed terms via additions to the common terms in our charging rules.

We recognise that harmonising terminology may be more beneficial for developers which work across company boundaries, and for alternative providers such as SLPs and NAVs, than for smaller developers that work with only one company. However, single-company developers may also benefit from the increased transparency resulting from harmonised terms. Although we accept that benefits might accrue to some stakeholders more than others, this does not undermine the fact that increased commonality is worth pursuing.

We welcome the point made about local variations in the use of terms. We accept that developers working across companies may be familiar with different terms for the same activity (for example footpath surfaces may be concrete or tarmac). Nonetheless it is important that, where such variations do exist, they are recognised and apparent. Consequently, we think a pragmatic way forward would be for the definition of certain terms to acknowledge local variations. We provide more detail on this in section 1.2.

In terms of the process by which greater harmony in terms may be realised, we believe we are not well placed to lead on this. Consequently, we are looking to industry to take this forward in good time for 2022-23 charges. We acknowledge the concerns surrounding sharing sensitive information but think the risk is manageable by companies. We also acknowledge there is an issue around transition to new terminology that will need to be managed carefully to minimise both disruption to customers and administrative burden for companies.

We recognise the point made that companies' Boards must retain ownership of charges and charges structures. We expect companies to retain overall responsibility for their own charges.

1.2 Responses to question 2

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

1.2.1 Summary of responses to question 2

Most respondents suggested helpful amendments to our proposed definitions, as well as some new definitions and deletions. There were some common amendments proposed, including to:

- the definitions of ‘carriageway’ and ‘footpath’. Several companies noted these are too specific (referring only to tarmac), as surface types can be of various materials. Some companies (including United Utilities, South Staffs Water and Wessex Water) would prefer definitions to be based on usage (for example ‘pedestrian’ or ‘vehicle access’) rather than surface type. United Utilities added it would be most appropriate to use the relevant definitions in the Highways Act. CCW made a similar point that definitions should be consistent with existing national specifications that water companies and their contractors have to meet, such as the [Specification for the Reinstatement of Openings in Highways](#).
- the definitions of ‘long length’ and ‘short length’ of new pipes. Several companies noted they use different lengths of pipe compared with our definition, and others take a different approach. For example, Anglian Water refers to ‘far side’ and ‘near side’ and considers our proposal inappropriate. And Wessex Water explained our proposal was not aligned with all companies’ approaches and that it charges on a per-metre basis for lengths longer than 2 metres and hence believes our terms could cause confusion.

WA Consultancy and Technical Development Services do not agree with Ofwat providing definitions and believe that the best way to promote harmonisation is to have engagement with the full range of developer customers. Several other respondents agree that a range of stakeholders, including water companies, SLPs, NAVs and developers, should be involved in defining the final list of definitions for the glossary.

Northumbrian Water commented that no company should be able to change common terms, but should be able to augment them with company-specific terms where appropriate. This echoes the point made by Bristol Water (section 1.1) about local variations, as well as the comments from some respondents about different types of surface materials being in common use.

Wessex Water suggested that definitions should be self-contained, in other words there should be no overlap with other definitions, and that diagrams might be helpful.

1.2.2 Our view

We are grateful for the inputs from respondents as we recognise we are not the experts in this field. It was apparent from the responses that companies and other stakeholders would value greater consistency between companies and clarity of terms. It is also clear that significant variation exists in companies’ individual practices, which is likely to be a natural consequence of the evolution of developer services from a series of local markets into one which provides opportunities to compete nationally.

Consistency between companies in the terms they use is good for customers and will support markets. We think there is scope for further consistency, but not to the extent of prohibiting local variations where there is solid justification for these (such as clear support from customers). We see scope for a pragmatic way forward, aligning terms where possible, allowing some variations to exist but ensuring that developer services customers are in no doubt about what a term means, no matter which company they are dealing with.

We are looking to the industry to work together to achieve greater consistency, and to do so in good time for 2022-23 charges. In practice, this means work would need to be finalised by summer 2021, to provide companies enough time to prepare and engage on their charging arrangements. This work may be led by Water UK, or perhaps by a small number of companies on behalf of the sector, and we are pleased that some companies have already come forward to offer to play a leading role. A working group would provide an opportunity for joint working and Ofwat is willing to consider how it might facilitate this. We are keen to engage with those companies prepared to lead the work how we might effectively do that.

We agree that it is important that developers, NAVs and SLPs should be given the opportunity to be included in the work. We will liaise with CCW about how we can secure effective engagement from across the sector. All parties involved must approach the work in a constructive and timely fashion, taking views properly into account.

1.3 Responses to question 3

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?

1.3.1 Summary of responses to question 3

All respondents agreed in principle with the proposal to have more explicit expectations on the presentation of worked examples.

Several companies (Anglian Water, Northumbrian Water, Southern Water and Wessex Water) cautioned that there should be a reasonable level of granularity required and

that overly complicated specifications will not be in the interest of developer customers. Wessex Water said that infrastructure charges should be excluded.

Bristol Water agreed with the proposal in principle, but explained that it has consulted with developer customers and does not want to replace the existing worked examples with alternatives that would not add much value to their customers. It also stated that Ofwat should consider whether developers' responses to this consultation demanded change from the current presentation of worked examples.

South East Water suggested that it may be useful to ask for customer feedback on examples they would like to see and the detail of any proposed changes to Ofwat's requirements should be consulted on as early as possible to ensure companies have no issues with providing the specified details. Yorkshire Water also highlighted the importance of consulting on the worked examples and building them through engaging with all types of developer customers.

Thames Water and Affinity Water were specifically mentioned by two respondents as having clear worked examples in their 2019–20 charging arrangements. Wessex Water's approach was also supported by a respondent.

There were a number of suggestions about making the worked examples more effective.

- Sutton and East Surrey Water suggested that the right level of detail is one that allows for understanding the assumptions being made and there is a clear link to the associated costs. Similarly, Severn Trent, South West Water and Wessex Water said adequate commentary should be added to the worked examples.
- CCW felt that a minimum requirement would be for companies to include all cost components rather than just totals. Fair Water Connections suggested companies should provide sub-totals for contestable and non-contestable work, so housing developers can be clear about the options available to them.
- South West Water suggested that where companies' examples differ from the requirements set in the standard template, they should clarify the differences and their assumptions. It also expressed support for companies to use standardised graphics for the worked examples.
- Thames Water proposed that the worked examples should include all charges for activities and materials expected in an average job in the surface type being used.

Two respondents (Thames Water and Fair Water Connections) explicitly supported retaining the same scenarios we set out in last year's information notice, but with more clarification.

There were a number of suggestions on making the requirements for the worked examples more specific:

- Ancillary charges should be included, such as:
 - traffic management charges,
 - metering costs,
 - design and admin types of charges, and
 - water for construction which is typically required on building sites;
- Specify whether a service connection charge is for a “tapping only connection” or should it also include service pipe and boundary box fitting excavation and reinstatement;
- For the block of flats scenario – specify if manifolds should be used; and
- Specify if connections are made in a sensitive or non-sensitive road and that an under-pressure connection to the existing main is required.

1.3.2 Our view

The original objective of the information requirement to include a statement for significant changes for new connection charges was to provide transparency on [bill stability](#) – demonstrating if bills for a set of scenarios had increased by more than 10% from the previous year and explaining what might have driven such increases and what handling strategies were considered and put in place. After reviewing companies’ examples in the 2020–21 charging arrangements, it became clear that many companies used the scenarios we set out for the bill stability requirement to present their worked examples as well. However, a number of companies did not provide sufficient detail or cost itemisation for those scenarios on bill stability to provide sufficiently clear worked examples at the same time. This is why we proposed to make more explicit expectations on how companies present the worked examples set out in our bill stability requirement.

The consultation responses support our stated objective to make the requirements around the presentation of worked examples in our annual information notice² clearer. We agree that there should be a balance between setting more explicit requirements and ensuring the worked examples do not become too detailed and consequently less user-friendly.

² “Expectations, assurance and information requirements for water company charges”.

The consultation responses provided valuable suggestions to improve the current set of scenarios. We have not replaced the broad scenarios we set out last year, but have taken stakeholders' views on board by including further clarifications in [the information notice for 2021-22](#), including clearer identification of which charges would be applicable should the contestable infrastructure be self-laid. The underlying principle for worked examples is that customers are able to follow through from tables of charges to the worked examples, and then to their own bills. Customers will benefit if companies provide better and more consistent worked examples and clarity on what services are included and excluded in charges, and to present relevant component costs not just total costs.

Several respondents highlighted the importance of ensuring the presentation of worked examples reflects the needs of developer customers. We agree with this and think this is consistent with our wording in last year's information notice. We expect water companies to provide additional or alternative scenarios where there are issues identified with the scenarios we have described or to highlight specific items that could be of particular interest to their customers.

When we first issued the charging rules we wanted to provide for more flexibility around worked examples and to allow time for the requirement to be settled and refined, so the information notice was at that time a more appropriate vehicle. We now believe we can formalise this requirement in the charging rules and intend to do so for charges for new connection services from 2022-23.

1.4 Responses to question 4

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

1.4.1 Summary of responses to question 4

Six water companies did not identify significant areas of our analysis that could be improved (Affinity Water, Northumbrian Water, Portsmouth Water, Sutton and East Surrey Water, Southern Water and United Utilities).

Water UK and one consultant did not respond to this question. The joint response from two other consultants referred to their published paper on developer services as being

relevant to questions 4 to 8, but did not specify any details. We have carefully considered the response for all relevant points.

The other responses, from nine companies, a NAV, CCW and a consultant, provided various general comments on the analysis:

- Bristol Water said it was difficult to draw conclusions from high-level analysis but said that charges are a function of several factors and adopting a common methodology is unlikely (on its own) to reduce the range of charges or identify if the range is simply a function of the market.
- South East Water said our analysis goes some way to identifying why charges differ between companies, but more detail is needed. Similarly, Wessex Water said our analysis should specify exact scopes and materials used in order to improve cross-company comparison.
- Anglian Water suggested that analysis using actual cost data at quoting stage or final cost reconciliation may reveal different results than analysis based only on data from companies' published charging arrangements, because costs of real developments can (and usually will) differ from example scenarios.
- Severn Trent suggested further analysis should be accompanied by a request to companies to validate Ofwat's calculations as well as the data gathered, to test whether companies recognise the overall costs for a typical scenario.
- Thames Water noted that the way companies present their charges (bundled or separated) can lead to inconsistent comparisons between companies. For example, it said its analysis of Bristol Water's charges suggested some costs (laying of service pipe, provision and installation of boundary box, reinstatement) were not included by Ofwat, which meant Thames Water's charges looked much higher by comparison. It believes Ofwat's conclusion (that there is no link between higher charges and higher SLP penetration) may be incorrect.
- Thames Water commented on the market share of SLPs in its area. It said if we were to take a different approach that accounted for a specific issue in its area (percentage of new mains installed by SLPs rather than number of connections) SLP market penetration would be much higher than we had presented.
- Fair Water Connections made the point that total costs may be similar but the allocation of costs can be very different.
- Independent Water Networks highlighted that off-site charges were not in the scope of our report but felt strongly that similar issues exist, and hence should be included in the scope of the work on the proposed industry group.

Some respondents suggested further work could be carried out, and could consider:

- regional factors like topography; population and housing density;

- off-site charges;
- more detail about which costs are included and excluded;
- cost allocation and recovery of overheads and non-contestable work;
- traffic management and road closure costs, council charges; and
- consideration of wastewater services.

1.4.2 Our view

The purpose of our analysis was to compare companies' published charges using a standard set of scenarios. We acknowledge the view from a few respondents that they would prefer a greater level of detail in our analysis, but we do not agree that conclusions cannot be drawn without it.

We agree with Thames Water's general point that the extent to which companies bundle charges can make comparisons difficult, which is why we are keen that companies improve their use of worked examples and collaborate on presenting charges consistently. As we explained in the consultation document, we went through an extensive process of identifying and then validating all the figures we used in our scenarios with all companies and incorporated their corrections before finalising our analysis. We had also looked at a number of different scenarios for service connections and mains requisitions and we found large variations in charges in all of them.

Anglian Water notes that our analysis is based on charges information drawn from information published online and applied to a specific scenario, rather than a comparison of actual costs between companies. It suggests actual costs of a real development are likely to differ from example scenarios, because of things like ground conditions and other unexpected factors. There are always likely to be variations in overall costs between an example scenario and one based on a real development. However, our analysis was of all companies' published charges applied to the same scenarios, which mimics what developer customers and other stakeholders are likely to do. If our comparisons reflect differences in, for example, ground conditions, then this should be across companies' areas as a whole rather than individual sites. We do not consider the variation at individual sites to be relevant here.

Many respondents identified no substantive areas for improvement. Some have suggested areas for further analysis, which we found useful. Overall, we did not find information in the responses that was sufficient to explain the wide variations in charging levels. We therefore intend to carry out further analysis of companies' published costs and charges.

1.5 Responses to question 5

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.

1.5.1 Summary of responses to question 5

All respondents suggested reasons for the observed differences in charging levels, many of which echoed the reasons suggested by us in our [May 2020 consultation](#).

Nine companies highlighted the importance of geographical factors, namely differing labour costs, council costs, traffic management costs, costs of materials and significant differences in local housing markets, when analysing charges. CCW emphasised the importance of population and housing density. South West Water said its more remote location limits the number of available market suppliers willing to work in its region, which could have an impact on contractors' rates and consequently on charges. Bristol Water said COVID-19 is likely to affect the housing market for many years to come and, as company overheads are largely fixed, it would be more challenging than usual to interpret data.

Eight companies and a NAV suggested differences may be because incumbents have different approaches to how costs are allocated. Specifically, incumbents will have different contractual agreements, they may bundle services in different ways, have different approaches to sourcing activities and there may be differences in the way that costs are allocated. Severn Trent makes the point that it is possible for contractors to accept low unit rates on some jobs because they make high margins on others. It also suggested that companies might be allocating overheads and shared costs differently. CCW says companies should scrutinise contractors' costs in detail to ensure they are cost-reflective.

Yorkshire Water, South East Water and Northumbrian Water state that it is difficult to comment on the variances in charging levels without understanding how companies have structured their charges. Northumbrian Water added that competition law acts as a barrier to it knowing how other companies have charged. It also said price is not the only factor developers consider when choosing their service provider.

Respondents mentioned other possible factors for charges varying, including:

- Bigger incumbents are more likely to be able to realise economies of scale or adjust to fluctuations in work volumes.
- Incumbents use different definitions and hence costs can be allocated in different ways.
- A simple comparison of costs may miss fundamental cost drivers such as length of service pipes and on-site mains.

Fair Water Connections believes a major factor in the variation of charges is because they are set on the basis of WIA91 rules, particularly the need for companies to maintain the ‘balance of charges’³. It argues in favour of a new approach.

CCW states that a key driver of the difference in charging levels is that there is no separation of off-site (single property) and on-site costs (large developments). Developers serving single properties are likely to be smaller, with higher administration costs. These differences should all be reflected in the charging rates offered by companies’ contractors.

Anglian Water, Northumbrian Water, Sutton and East Surry Water, Southern Water, Thames Water and Yorkshire Water made the point that variations in charges are not a problem as long as charges are cost-reflective. Wessex Water said there are legitimate factors for cost differences, which should be of no concern as those differences are controlled by cost assessment in the price control.

1.5.2 Our view

We are grateful for the insights from respondents as to why costs may vary between companies.

The point made by Fair Water Connections about the ‘balance of charges’ is not likely to impinge on the variability of charges between companies, because companies still need to set charges that relate to the cost of the work carried out under each charge (with income offset being set to meet the balance).

CCW’s point about single property sites and large developments is not likely to affect our main findings. We have used specific scenarios to compare charges across

³ The regulatory framework for setting the relevant charges was set out in the WIA91 itself, prior to the sections allowing Ofwat to issue rules coming into force. These sections are still in force in relation to companies wholly or mainly in Wales.

companies for equivalent activities, including the costs for single connections for different types of surfaces and lengths – such as unmade ground, made ground and carriageway. Our requisition scenarios also included specific details for the connection to the existing main to allow for consistent comparison. The range of scenarios we used meant that we did look at differences in the charges being set for individual connections as well as multiple-connection developments.

We agree that some drivers of the difference in new connections charges may be exogenous (or outside company control), such as geographic or regional factors. We are also concerned that some drivers may be endogenous (within company control), specifically the methodologies companies use to allocate costs and set charges.

We understand that companies have different approaches to contracting for developer services. We did highlight in our findings of the [Review of incumbent company support for effective markets](#) that charges that are below cost can act as a barrier to competition. Taking contractor rates as given is not sufficient to ensure cost-reflectivity – when a basket of services includes both contestable and non-contestable services there is the potential that the provider cross-subsidises contestable rates with non-contestable revenues, in order to appear to be providing better value for money for the incumbent.

We agree with the view held by some companies that differences in charges are not necessarily a problem, as long as charges are cost-reflective. As we state⁴ in the context of off-site charges, we encourage companies to set charges that reflect cost differences, where it is in customers' interests to do so. However, our concern here is that charges may not, in fact, be cost-reflective, or reflect the right costs at the right level.

Overall, we did not find information in the responses that was sufficient to explain the wide variations in charging levels. We therefore intend to carry out further analysis of companies' published costs and charges, which may help identify relevant exogenous and endogenous factors. We are likely to commission further work to look into this in more detail.

⁴ See paragraph 33 of our [Charges Scheme Rules from April 2020](#). "As long as the difference between amounts is cost-reflective, the amounts of Infrastructure Charges may vary to reflect different circumstances and, in particular, may be different for different geographical areas."

1.6 Responses to question 6

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?

1.6.1 Summary of responses to question 6

Most respondents support our proposal to include cost-reflectivity as an explicit principle in our charging rules. Of these, Yorkshire Water and Independent Water Networks strongly supported our proposal. Other respondents offered additional comments to qualify their support. For example,

- Severn Trent and South Staffs Water say the change would be unlikely to have much impact on our findings of variation of charges, as companies already pursue cost-reflectivity in charging.
- Severn Trent adds that Ofwat could do a deep-dive if it is concerned about cost allocation.
- Thames Water and Anglian Water ask about the correct level of granularity for charges to reflect costs. Similarly, Northumbrian Water says most developers in its area want charges that are less disaggregated than it has at present.
- South West Water says the rule should be unambiguous to avoid mis-interpretation.
- Thames Water, Wessex Water and Portsmouth Water agreed with the proposal and state that they already adhere to the cost-reflectivity principle. Wessex Water adds that it can be difficult to comply annually (as large projects take several years to complete, hence income is received up front but costs are incurred over time).
- Portsmouth Water says companies' Boards should confirm cost-reflectivity in their Assurance Statements.
- Affinity Water says cost-reflectivity may require more frequent changes in charges, which will go against the principles of predictability and stability. It wants Ofwat to let companies balance the tension between cost-reflectivity and other charging principles.
- South East Water says an assessment is needed of the impact of the proposed cost-reflectivity principle on the overall level of charges and that companies should be given the chance to revise contracts if needed.

- Fair Water Connections supports any move that makes non-contestable charges cost-reflective although it is concerned companies may inflate costs unnecessarily to a ‘reasonable’ level.

Southern Water supports the proposal for a specific cost-reflectivity principle but opposes the inclusion of contractor rates in it. It believes the tendering process is a good proxy for cost-reflectivity and an assurance statement should be sufficient to show costs are not materially out of line with charges.

Anglian Water and United Utilities state that they believe cost-reflectivity is already required under current licence conditions and legislation, and therefore an explicit principle is not required. Bristol Water comments that there is no significant evidence that indicates that cost-reflectivity is not already applied.

CCW agrees in principle but suggests there is more analysis to be done on the causes of variation in charges before bringing in the modification. It highlights one company’s work on auditing contractor costs and states other companies should follow its example.

1.6.2 Our view

We stated in the consultation that the differences in levels of charges are so marked that they are unlikely to be a function of cost alone. Charges that are not cost-reflective may undermine the principles of fairness, transparent and predictability.

We explained in our [Review of incumbent company support for effective markets](#) that incumbents need to take responsibility to ensure that their own charges reflect their costs, including where they use outsourced contractors.

We acknowledge that the need for cost-reflectivity is a well-established regulatory expectation. We agree that charges should already be cost-reflective, but our analysis suggest that this may not be the case for every company or every scenario we examined. All respondents agree that cost-reflectivity is important and most agree with our proposal to introduce an explicit charging rule. We are not persuaded by the point that introducing an explicit requirement for charges to be cost-reflective will lead to less stable charges. This can be addressed by reference to long run costs, as is already the case in other charging rules. Nor do we think that it would create tensions with other charging principles but we are willing to review this if companies bring forward evidence. Furthermore, we are not persuaded that excluding contractor costs from any assessment of cost-reflectivity would strengthen confidence that charges were aligned with charging principles.

Therefore, we are minded to proceed with our proposal to change our charging rules to include an explicit requirement for charges to be cost-reflective.

1.7 Responses to question 7

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

1.7.1 Summary of responses to question 7

Most respondents provided views on the potential benefits and disbenefits for having a common charging methodology, without explicitly supporting or rejecting the idea. Some of the key benefits that were highlighted are:

- benefits to developer customers who operate at a national level;
- more transparency and less ambiguity;
- positive effects on competition through greater transparency; and
- increased confidence in comparability of charges and that differences are based on costs rather than methodological variations.

The main disbenefits put forward in the responses are:

- competition law concerns;
- innovation could be stifled;
- could inhibit competition and affect D-MeX⁵;
- smaller developer customers may be alienated if benefits are targeted at those operating at national level; and
- high implementation costs, which will have an impact on charges.

Severn Trent also referred to the experience in the energy market, where Ofgem's past reforms that limited the number of tariffs in the market was criticised, reducing differences in tariffs also reduced choice and had a negative impact on competition. It

⁵ D-MeX is the Developer Services Measure of Experience, an incentive mechanism on companies that measures the quality of services to developers and other third parties. Each company is ranked and receives financial rewards or penalties depending on their performance compared with other companies.

also pointed out that the introduction of D-MeX has brought comparative competition between water companies, which would make an alignment in approaches to charges more complex.

United Utilities and Wessex Water explained that company Boards have a responsibility to approve charges and need to retain ownership of charges if a common methodology was implemented. United Utilities added it would be better to have voluntary measures or guidance to improve the level of standardisation in presentations and comparability of charges – overly prescriptive methodologies could create a conflict with the responsibilities of companies. While the company was “positively disposed” towards better standardisation of charging structures, more consistent presentation of charges would help deliver comparability without compromising flexibility. United Utilities and Wessex Water also highlighted that engaging with key customer stakeholders is key and is needed to reveal how (and if) they think charges should be standardised.

Yorkshire Water, Sutton and East Surrey Water and Independent Water Networks explicitly supported the idea of a common methodology. Yorkshire Water noted the possibility of negative incidence effects affecting some customers. Independent Water Networks explained that it needs to raise a large number of clarifications about charges. However, in line with most other respondents, it made the point that the requirements should not be too prescriptive, so there is scope for companies to innovate.

South Staffs Water, Portsmouth Water, South East Water and Water UK explicitly disagreed with the idea that companies should adopt a common methodology, because of competition law concerns. South Staffs Water also explained that a common methodology could have impacts on D-MeX performance, impose significant implementation costs and remove the current responsibility of companies to make a judgement on how to balance between having granular charges and averaged simple charges at the same time. Portsmouth Water said collaborative work in this area could reveal too much commercial information, such as how companies make contractual arrangements.

Some respondents (Anglian Water, Thames Water, CCW) did not believe it necessary to work on a common charging methodology if our other proposals are implemented (regarding common definitions and ensuring there is greater transparency in the presentation of charges and worked examples). Anglian Water asked for a Regulatory Impact Assessment to be carried out by Ofwat. CCW also pointed out that companies should work with their contractors to ensure that their schemes of charges are cost-reflective.

Fair Water Connections was less concerned whether there is a common methodology, but asked for more work on ensuring companies are compliant with the current set of rules.

1.7.2 Our view

We are grateful for the feedback on the benefits and disbenefits of adopting a common charging methodology. It is clear that there are numerous, credible arguments both in favour and against companies aligning their charging approaches.

It appears from comments received that there were different interpretations of our proposal for a “common methodology”. We explained in our consultation that a common charging methodology could include greater harmony across the use of terms and definitions and some consistency in the definition of a package of charges. There is much support from respondents for these aspects of a common methodology. There is also widespread support for joint working, under the right conditions and with relevant stakeholders included.

In our consultation we also suggested companies could align in their approach to allocating overheads and the how they might demonstrate that contractor rates reflect actual costs. For the avoidance of doubt, it was not our intention that the methodology would require, for example, consistent metrics or tables of charges. Rather, a common methodology should give greater assurance that charges are fair. Neither do we want to prescribe how companies should define and set each individual charge. Our assessment based on current evidence is that that would be overly prescriptive, potentially inhibiting companies from innovating or hinder effective procurement.

However, at this stage, we do not expect companies to jointly take forward work on the aspects of a common methodology pertaining to allocating overheads and contractor rates. Instead, we intend to carry out further analysis of companies’ published costs and charges, which may help identify relevant exogenous and endogenous factors.

Nevertheless, it is still open for each company to show how it allocates costs (including overheads) appropriately and ensures that its procurement of external support is cost-reflective and efficient. We welcome the confirmation from one company that it is incorporating the feedback from our [Review of incumbent company support for effective markets](#) in its current procurement exercise for a new supplier.

1.8 Responses to question 8

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.

1.8.1 Summary of responses to question 8

Responses from water companies highlighted that they had competition law concerns related to our proposal and they were particularly concerned with working on harmonising charging methodologies. Most respondents suggested having a form of regulatory requirement for the work or for Ofwat to lead it. CCW also felt that Ofwat should chair the working group. Another common suggestion was the inclusion of customer representation in any working group.

Eight water companies (Affinity Water, Northumbrian Water, Sutton and East Surrey Water, Southern Water, South West Water, United Utilities, Yorkshire Water), Independent Water Networks and CCW expressed general support for the high-level scope of the working group, with some qualifications.

- Southern Water agreed with the proposal in general, but contractor rates should be left out of scope.
- United Utilities suggested modelling any group on the Retailer Wholesaler Group in the business retail market – it delivered a number of best practice guides rather than industry standards, which allowed for the work to progress at pace.
- South Staffs Water agreed in principle, but did not support the adoption of common charging methodologies.
- CCW felt it was too early to say whether a common methodology should be made compulsory.
- Affinity Water explained it would be more comfortable if participation in the working group was a regulatory requirement within the new connection charging rules.
- Northumbrian Water noted that the examples of working groups we provided were all formally created by regulators and recommended such an approach.
- South West Water, Yorkshire Water and CCW recommended that the group should include developer customers.
- Independent Water Networks and CCW questioned why off-site connection works are not in the proposed scope.

Other respondents were less supportive of a working group.

- Anglian Water said it supports joint working but is not convinced a working group is needed. It would be willing to participate if one was set up and said SLPs and NAVs should be represented. It questioned whether contractor rates should be in scope.
- Severn Trent said it was not comfortable sharing information and D-MeX might make it difficult to align common approaches. It suggested a cross-industry audit instead to look where a common approach would be beneficial.
- Portsmouth Water said the biggest challenge to a successful working group would be securing support from customers, referencing the experience in the Codes for Adoption work.
- South East Water supported the Water UK response and added the need for additional clarity on the scope of a working group.
- Wessex Water had serious competition law concerns to the extent that it would not participate in such a group unless it was a regulatory requirement.
- Water UK explained that the work envisaged by Ofwat could have an impact on external contracting and it could disadvantage some developer customers. As a potential solution to addressing those concerns, it proposed that any such work is led by Ofwat. It did not support the adoption of common charging methodology, but it would work with Ofwat to set up a working group if it was to be adopted.
- Thames Water noted some complexities when looking at common methodologies. It proposed a small group including Ofwat, Water UK and some companies agree how to address competition law risks before the main working group commenced.
- Yorkshire Water, Thames Water, South West Water, Anglian Water and Water UK all questioned whether the proposed timescales were achievable.

Bristol Water said there was insufficient evidence to support a common methodology hence no need for a working group. It said analysis was based on 2019-20 charges, before the new arrangements came into effect in April 2020. It argued against a working group on grounds of proportionality and suggested that Ofwat should engage directly with developers in order to identify specific areas for targeted improvement.

Fair Water Connections said a working group was not desirable or necessary if current rules were more rigorously enforced. It added that if a working group was formed, it should not be led by Water UK.

1.8.2 Our view

Overall, responses to our consultation and the specific responses to question 8 supported industry collaboration on the terminology for and presentation of new connection charges, including the use of worked examples.

At the same time, we recognise that some stakeholders have concerns about collaborative working, both in terms of its interaction with the incentive applied through D-MeX and the general risk of infringing competition law. Some respondents also challenged whether we have definitively established the need to have a common charging methodology.

After careful consideration of the feedback we have received, including strong support for further work, and taking account of our view that “common charging methodology” covers a wide range of issues, we believe industry collaboration is both necessary and desirable. Furthermore, we think some form of working group is an effective way to proceed. We are encouraged that certain companies have already approached us with a view to taking a substantial role in bringing the sector together, to look at improving consistency in terminology. We welcome this demonstration of the leadership qualities we noted in our [Review of incumbent company support for effective markets \(RISE\)](#).

We also acknowledge companies’ concerns about joint working and the strong feedback for Ofwat to be involved in any group, particularly if the scope included consideration of contractors’ rates and cost allocation. We would like to reiterate our message from the RISE conclusions – in our view it is wrong for companies to use competition law as a reason not to collaborate to the benefit of customers. However, while it is for companies to manage their risks, we are willing to work with companies and relevant stakeholders to facilitate a working group, including supporting discussions about the scope of the work. And as we noted in section 1.7.2, we do not expect companies to work jointly on the other aspects of a common methodology, at this stage. Instead, we will carry out further analysis of companies’ published costs and charges in order to understand identify relevant exogenous and endogenous factors.

We do not believe joint working to improve consistency would undermine incentives under D-MeX, for the following reasons.

- D-MeX is about quality of service, hence companies should be looking to deliver great service irrespective of the degree of commonality involved.
- D-MeX compares the relative performance of companies, not companies’ performance against an absolute benchmark. So the incentive remains to do better than other companies, not better than a set standard. If the sector as a whole improves, the D-MeX reward and penalty structure remains valid.

- Companies that play a strong role in delivering improvements to the developer services market have the opportunity to enhance their reputation (and their D-MeX score).

We have set out next steps in greater detail in section 2.

2. Conclusions

In this section we set out our conclusions on further work to support the developer services market.

There is strong support from respondents for further harmonisation of terminology and for more effective use of worked examples by companies when presenting their charges. Respondents were in favour of Ofwat implementing these improvements through amendments to our charging rules and an enhanced information notice on charges. We also received support for our proposal to amend our charging rules to include a principle on cost-reflectivity and helpful suggestions for further analysis of why charges vary between companies.

On joint working, a common charging methodology and the use of working groups, views were mixed. Most respondents supported collaboration and many would participate in a working group to look at aligning terminology and the presentation of charges. A working group would work best if it had representation from all relevant stakeholder groups, as long as participation was constructive and timely. Many companies would also be willing to work together on other aspects of a common methodology, as long as there was some form of safeguard in place to mitigate competition law concerns. Some highlighted complexities with pursuing a common methodology, difficulties in sharing information and securing appropriate customer support. Some respondents questioned the need for a common charging methodology at all, or in the light of further work on harmonising charges.

We have carefully considered all the responses. We have concluded as follows.

- We look to industry (collectively, companies, Water UK and other stakeholders) to take forward work on improving consistency in terminology, as the first step in collaborating on charging where it benefits customers and / or supports markets to do so. We are keen for companies to step forward and take a leading role in this work and thank those that have already contacted us to say that they wish to do. We will consider how Ofwat might facilitate joint working and appropriate governance, involving CCW, stakeholders and customers, with the expectation that industry concludes the process in summer 2021, in time for 2022-23 charges. We propose to amend our charging rules to include the terms agreed through joint working and approved by Ofwat.
- We have published our [information notice on charges for 2021-22](#), with further guidance for companies on the use of worked examples. Our intention is to incorporate those requirements into the charging rules for 2022-23 charges.

- We will prepare a change to our charging rules to include a principle explicitly requiring cost-reflectivity in charges. This will come into effect for 2022-23 charges.
- We encourage companies to review their contractor rates and demonstrate how they apply appropriate scrutiny to assure customers that rates reflect the appropriate costs. We are pleased that one company is already acting on our feedback from our [Review of incumbent company support for effective markets](#).
- We encourage companies to show more clearly how they allocate costs and overheads in their published charges.
- We intend to carry out further analysis of companies' published costs and charges and are likely to commission external support to help us.

We believe there is opportunity for companies to show leadership in improving outcomes for customers through collaborative and innovative work. We are willing to discuss with companies how they might wish to work more closely to support the developer services market, while maintaining ownership of their own charges and charging structures.

Appendix 1: List of respondents

1. Affinity Water
2. Anglian Water
3. Bristol Water
4. Fair Water Connections
5. Independent Water Networks
6. Northumbrian Water
7. Portsmouth Water
8. Severn Trent
9. Southern Water
10. South East Water
11. South Staffordshire and Cambridge Water
12. South West Water
13. Sutton and East Surrey Water
14. United Utilities
15. Technical Development Services and WA Consultancy – joint response
16. Thames Water
17. CCW
18. Wessex Water
19. Water UK
20. Yorkshire Water
21. An independent consultant

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