

July 2021

New connections charging rules for Welsh companies – decision document

Executive Summary

In February 2021, [we consulted](#)¹ on options for setting rules for charging for new connection services for **water companies whose areas are wholly or mainly in Wales** (“**Welsh companies**”²).

The framework for setting these charges is currently set out in the Water Industry Act 1991 (the Act). However, this framework is inflexible and time-consuming because it requires amendments to primary legislation to implement any changes to the way charges are set.

The Water Act 2014 recognised this inflexibility and introduced a new framework for the regulation of charging in the water industry, which enables Ofwat to set charging rules instead, subject to guidance from the Welsh Government. This allows us to monitor developments and respond to them more easily and to resolve potential breaches of our rules by issuing enforcement directions to bring Welsh companies into compliance with the rules. By changing the current charging framework, we can address stakeholders’ concerns about the lack of predictability and transparency in charges and the perception of double-charging for the same work, which can reduce confidence in charging.

This document summarises the responses to that consultation and sets out our decisions on the way forward.

Respondents’ views

We have published all responses in full on our website. We are grateful to respondents for their comments, insights and challenges. Overall, responses showed:

- the Welsh companies and other stakeholders supported the introduction of new connection charging rules; none of the respondents favoured retaining status quo;
- the Welsh companies supported more permissive charging rules which provided more freedom over how they set their charges. Other stakeholders typically supported more detailed and specific charging rules;
- Hafren Dyfrdwy had concerns with the potential regulatory burden of some of the proposed charging rules and whether the implementation of some of the rules would be practicable for a company with a small customer base;
- several stakeholders provided suggested improvements to specific charging rules; and
- two stakeholders raised concerns around our proposed timing of the implementation of the charging rules.

¹ [Consultation on new connections charging rules for Welsh companies - Ofwat.](#)

² Currently these companies are Dŵr Cymru, Hafren Dyfrdwy and Albion Eco Limited.

We have carefully considered the points made and, where appropriate, amended our proposed way forward.

Our decisions

We have decided to set charging rules based around our proposed option 2, which is where we set specific, targeted rules. As part of this, we will include a charging rule that requires a clear separation between charges for site-specific work and a single infrastructure charge that covers all network reinforcement costs; we will make change to income offset, including that it is applied to infrastructure charges; and we will require the Welsh companies to set fixed upfront charges for site-specific water and wastewater services, except in cases where it would be unreasonable to expect them to do so.

To improve the stability of the infrastructure charge, we will allow smaller companies to set this charge using cost data published by other companies as well as their own.

We have decided to defer the introduction of these rules to 1 April 2023 to allow companies to undertake more engagement with stakeholders in the introduction of their new charging arrangements.

Contents

1.	Consultation responses	4
1.1	Responses to Question 1	4
1.2	Responses to Question 2	6
1.3	Responses to Question 3	8
1.4	Responses to Question 4	11
1.5	Responses to Question 5	13
1.6	Responses to Question 6	15
1.7	Responses to Question 7	16
1.8	Responses to Question 8	18
1.9	Responses to Question 9	19
1.10	Response to Question 10	20
2.	Decision to defer introducing the new charging rules until April 2023	22
3.	Next Steps	24

1. Consultation responses

In our February consultation we focused on three options for the approach we could take to setting new charging rules for Welsh companies in order to show examples of what the charging rules could look like:

- **option 1** – keep the **status quo**, setting charging rules that maintain the current charging framework for new connection services;
- **option 2** – set specific, **targeted rules** that companies must comply with when setting charges for new connections services; or
- **option 3** – set general, **light-touch rules** that give companies more freedom in designing and implementing their charges for new connection services.

We received seven responses to the consultation, from the following organisations:

- Dŵr Cymru – A Welsh water and wastewater company;
- Hafren Dyfrdwy – A Welsh water and wastewater company;
- The Consumer Council for Water (CCW) – the statutory consumer body for the water industry in England and Wales;
- Independent Water Networks Limited (IWNL) – an appointed water and wastewater provider;
- Fair Water Connections (FWC) – an association which provides support to Self-Lay Providers;
- The Home Builders Federation (HBF) – a representative body of the home building industry; and
- Persimmon Homes – a large housebuilding company.

We have published their responses on the associated consultation page of our website, [here](#).³ While the Welsh Government did not formally respond to this consultation, we have also been in discussion with Welsh Government during the process.

1.1 Responses to Question 1

Q1: Do you agree with our proposal to redefine what costs are recovered by infrastructure and requisition charges?

What we said in our February consultation

We proposed a charging rule that would reclassify all works as either:

³ www.ofwat.gov.uk/consultation/consultation-on-new-connections-charging-rules-for-welsh-companies/.

- site-specific, by which we mean works that are on, near to or in the immediate vicinity of the development; or
- network reinforcements;

and that:

- infrastructure charges are set to recover network reinforcement costs (so there is no longer a cap on these charges); and
- requisition charges only recover mains or sewer costs for site-specific works.

This would ensure that there is a clear distinction between the costs each charge is intended to recover, addressing the current concerns that developers may be over charged for some network reinforcements.

Respondents' views

All of the stakeholders that responded to this question were in favour of having a clear separation between the charges for site-specific works and network reinforcement work.

FWC proposed an alternative approach to defining what counted as site-specific, which would include everything up to the nearest water main or sewer of equivalent size or larger.

FWC also suggested that the charging rules should set out how charges should be set in situations where network reinforcement work also provides infrastructure enhancements as well as the enhancement capacity necessary to cope with additional demand from the new developments.

Dŵr Cymru, while supporting the proposed approach, noted that this could have the disadvantage of developers engaging with the water companies at a later stage in the process resulting in an increase of instances where development plans and infrastructure programmes do not align.

Our assessment and decision

As all respondents agree with the proposal, we will include a charging rule that requires a clear separation between charges for site-specific work and a single infrastructure charge that covers all network reinforcement costs.

We recognise that there are alternative approaches we could take for defining the boundary between work that is classified as being on-site or network reinforcement and there will be potential benefits and drawbacks with each potential option. However, several stakeholders have emphasised in their responses the benefits of having charging regimes in Wales and England that are broadly aligned to make working in both Wales and England simpler to undertake. It is not clear that the approach for defining on-site work proposed by FWC would provide benefits that would outweigh the downside of adding unnecessary differences between the charging regimes in England and Wales. As a result, **we will use the definition**

of site-specific work and network reinforcement that we proposed in the consultation document.

We do not propose to set a specific charging rule to address how charges should be set where network reinforcement works provide infrastructure enhancement in addition to providing additional capacity for development. The proposed Charges Scheme Rules already require that infrastructure charges do not recover costs incurred in providing enhancements to existing infrastructure that are unrelated to the provision of new developments. Where a Welsh company undertakes work that provides both network reinforcement capacity and infrastructure enhancement, the general charging principles and the details of the specific works should inform how it decides to allocate these costs.

1.2 Responses to Question 2

Q2: Do you agree with our proposal that infrastructure charges should be calculated to recover costs incurred over a rolling period of years?

What we said in our February consultation

We proposed that infrastructure charges are set to recover costs incurred over a rolling period of years, rather than set to match the costs incurred in any particular year. This recognises that reinforcement works may not be carried out in the financial year in which the associated new development is undertaken, especially for larger developments.

The proposed approach would also help to avoid significant annual changes in infrastructure charges as the costs of any significant one-off reinforcement works could be recovered over a number of years.

Respondents' views

None of the respondents to the consultation objected to basing infrastructure charges on the averaged costs incurred over a number of years, rather than the specific reinforcement costs that the Welsh companies would incur in a single year. All of the respondents except for Hafren Dyfrdwy and FWC supported the approach of basing the infrastructure charge on a rolling period of years. CCW and IWNL noted the benefits of having an approach that aligned with existing charging regime in England to assist customers that operate in both Wales and England.

FWC had concerns that the proposed approach would still lead to significant annual variability of the infrastructure charges as they are recalculated each year. This would lead to self-lay providers (**SLPs**) having to renegotiate terms with their customers during a development that the SLP is providing, due to this charge which is outside their control. FWC considers this harms the ability of SLPs to compete with the incumbent Welsh companies.

FWC proposed that the infrastructure charge should be fixed at the point where the agreement to provide the service is made rather than changing on an annual basis.

FWC also asked for the charging rules to make it clear about how any water efficiency discounts that are applied to the infrastructure charge should be funded.

The issues raised by Hafren Dyfrdwy to this approach are set out in section 1.3 below.

Our assessment and decision

We agree that the Welsh companies should be transparent in how any discounts on their infrastructure charges are funded. We have proposed a rule that require the Welsh companies to explain the methodology for setting their infrastructure charges and a principle requiring them to set transparent charges.

Regarding the impact of having infrastructure charges that can vary each year, infrastructure charges are payable by the owner of the premises to the water company when the new connection is made, regardless of who makes the connection. Infrastructure charges are due when the connections are made to the public water or wastewater network, which could be years after a development has begun. Therefore the charges should be at the level set by the water company in that charging year.

The variability of these charges is also the same regardless of whether the customer chooses to procure new connection services from the incumbent water company or an SLP. As a result, we do not consider that having an infrastructure charge that changes annually should harm the ability of SLPs to compete with the incumbent Welsh companies. Where an SLP is concerned about the potential variations in the infrastructure charge, it has the option of providing the new connection service for the customer, but leaving the infrastructure charge as a matter between the owner of the newly connected property and the relevant Welsh company.

We will therefore include a charging rule that requires Dŵr Cymru to base its infrastructure charges annually on the expected costs of network reinforcement works and the expected number of new connections that will be made over a rolling period of years.

We will set a different charging rule covering infrastructure charges for Hafren Dyfrdwy. We set out this approach and the reasons for it in section 2.3 below.

1.3 Responses to Question 3

Q3: Do you prefer option 2 or option 3 (or another approach) as the basis for setting the relevant time period over which costs are calculated for the purpose of setting infrastructure charges?

What we said in our February consultation

We considered the appropriate number of years of expected reinforcement costs and new connections which the water companies should consider when setting their infrastructure charges. Hafren Dyfrdwy had previously provided evidence to show that using a rolling five-year period (option 2) would not work properly when applied to it as it would expect to have periods of more than five years in which it would not carry out any network reinforcement work. We asked stakeholders for their views on whether a rolling ten-year period (option 3) would be reasonable and whether this larger period should also be applied to Dŵr Cymru.

Respondents' views

Dŵr Cymru suggested basing the water infrastructure charges on a rolling five-year period and wastewater infrastructure charges on a rolling ten-year period. This is on the basis that wastewater reinforcement works tend to be less frequent, but larger scale than water reinforcement works. This would help to reduce the volatility of the wastewater infrastructure charges.

FWC and IWNL supported a five-year rolling period. IWNL noted that there is less certainty around the information over a ten-year period than a five-year period and the five-year period will use information that has been reviewed as part of our five-year price review process. FWC had concerns that using a ten-year rolling period would reduce the transparency of how these charges had been set and how they can be regulated by Ofwat. FWC suggested that infrastructure charges and the income offset could be fixed as part of our five-year price review process.

CCW considered that using a ten-year rolling period could be the correct approach, however it noted that there was limited information provided about each proposal and it would want to know more about the financial implications of using a ten-year period and who would bear the financial risks.

Hafren Dyfrdwy noted that it is the smallest of the incumbent water companies, providing far fewer new water connections than the next largest company, Portsmouth Water, and providing even fewer wastewater connections. As a result, it expects to have extended periods that can last for over a decade in which it does not have to provide any reinforcement works. Under our proposed charging rules, this would lead to periods in which the infrastructure charges would fall to zero, even though the newly connected premises would be contributing to the eventual need for network reinforcement works to be undertaken.

When the reinforcement works do need to be undertaken, this would result in very large infrastructure charges to the few premises that are connected during this period.

Our assessment and decision

We recognise that there is a balance to be made between the stability, transparency and accuracy of infrastructure charges. Using a shorter period of time on which to base the infrastructure charges will tend to make the charge more transparent and accurate but lead to more annual variability and, in the case of Hafren Dyfrdwy, risk excluding some customers whose connections contribute to the eventual need for network reinforcement not contributing to the cost of it. Using a longer period of time would require the use of less accurate, longer-range predictions of future new developments and reinforcement needs, but tend towards having more stable infrastructure charges over time as yearly variations in new developments and reinforcement needs are averaged over a greater number of years.

We do not agree with the proposal for us to set the companies' infrastructure charges as part of the price review process. This approach would lead to stable charges over the five years of the price review, but could lead to significant step-changes between price review periods. It would also remove the Welsh companies' ability to adjust their charges based on any new information about the predicted number of new connections and need for network reinforcement works that may come during the price review period. This could lock the Welsh companies into inappropriate infrastructure charges and harm customers' interests.

The evidence provided by Hafren Dyfrdwy regarding the low volume of new connections made in its area of operation and the corresponding low frequency of network reinforcement works it is required to provide is compelling. We agree that requiring it to set its infrastructure charge on the basis of a rolling five or ten year period would not be appropriate due to the expected periods in which this charge would fall to zero, leaving the customers that made connections in the period before network reinforcement works were carried out facing disproportionately high infrastructure charges. Using a longer rolling period of years would also not be appropriate as this would rely on longer term projections of the numbers of new connections that will be made which can be expected to be increasingly less accurate.

However, we consider the five-year period to be reasonable for Dŵr Cymru, due to the much higher number of new connections made in its area. As a result, we have decided to set different charging rules for Dŵr Cymru from the other Welsh companies. We accept that for wastewater services, Dŵr Cymru's investments in network reinforcement may be more variable over time. But the forecast information which would be necessary in order to use a ten-year rolling period to calculate infrastructure charges can also be expected to be less accurate and therefore increases the risk of the infrastructure charge not being cost reflective. Other stakeholders also have a preference for using a rolling five-year period to base these charges and have concerns that a longer period would reduce the transparency of these charges.

For Dŵr Cymru, we will set a charging rule for both water and wastewater infrastructure charges which requires it to base these charges on a rolling five-year period of forecast network reinforcement costs.

In order for Hafren Dyfrdwy to set a reasonable infrastructure charge that meets our general charging principles, it must have a transparent methodology on which it is set, the charge must be relatively stable over time and reflect the costs of providing network reinforcement. However, Hafren Dyfrdwy typically does not provide network reinforcement works frequently enough to use its own cost information as the basis of this charge. We are therefore proposing to allow Hafren Dyfrdwy to use the published cost information from one or more other water companies as part of its calculation of its infrastructure charge. In order to do this, it would be required to use backward-looking costs rather than forward-looking costs as the forward-looking information from other water companies would not be available to Hafren Dyfrdwy at the time it is required to set its charges.

We recognise there are a number of advantages and disadvantages of this proposed approach.

The main advantages are:

- The information needed by Hafren Dyfrdwy in order to set its charges exists and is accessible to both Hafren Dyfrdwy and other stakeholders;
- The approach does not need to rely on long-term forecasts of network reinforcement needs and housing development levels;
- The charge should be relatively stable over time as it is based on an assessment of the combined costs incurred by more than one water company. This should lead to increased averaging and a more stable charge;
- It will ensure that the charges are based on actual costs incurred, even though much of the cost information would not be the costs incurred by Hafren Dyfrdwy; and
- The charges should be transparent and predictable for customers as the cost information on which the charges would be set would be available to the public the relevant water companies' Annual Performance Reports.

The main disadvantages of this approach are:

- The charge would reflect the costs of both Hafren Dyfrdwy and other water companies rather than just those of Hafren Dyfrdwy;
- There is no specific mechanism to address long-term over- or under-recovery of revenue by Hafren Dyfrdwy. This is because there could be several decades before there is sufficient actual information about Hafren Dyfrdwy's actual costs of reinforcement works to compare against the revenue collected; and
- The charge would rely on backward-looking costs rather than forward-looking costs due to the need for Hafren Dyfrdwy to have access to the relevant information on other companies' costs in time for Hafren Dyfrdwy to set its own charge. This means there

will be a lag between any significant changes that occur in the expected costs of network reinforcement works (for example, step changes in housebuilding, improved efficiency over time, new technologies etc.) and the infrastructure charge.

We do not propose to set a detailed methodology by which Hafren Dyfrdwy should set this charge. This will allow Hafren Dyfrdwy to consult with its customers and stakeholders on a practicable and acceptable methodology for setting infrastructure charges.

We also propose to apply this charging rule to Albion Eco for the same reasons as those set out for Hafren Dyfrdwy. Albion Eco has not connected any new household customers to its water or wastewater network. Therefore, it also has little information on which to base any potential future infrastructure charges. This proposal would future-proof the charging rules against any potential future decision by Albion Eco to connect new household customers to its network.

For the Welsh companies other than Dŵr Cymru we will set a charging rule that allows them to base their infrastructure charges on an assessment of the historical costs of network reinforcement incurred by both the Welsh company any other undertakers that it considers to be relevant.

We intend to use the following rule, to replace rule 28 (c) of the proposed Charges Scheme Rules.

(c) For Hafren Dyfrdwy and Albion Eco, the amount of such charges should be based on a reasonable assessment of the historical costs of Network Reinforcement incurred less any other amounts received for Network Reinforcement. This assessment should include the historical costs of Network Reinforcement incurred by the relevant undertaker and may also include the published historical costs of Network Reinforcement incurred by other undertakers where the relevant undertaker considers this to be appropriate when making this assessment.

1.4 Responses to Question 4

Q4: Do you agree with our proposal to simplify the calculation of income offset and apply it to the infrastructure charge, instead of the requisition charge (thereby removing the need for asset payments)?

What we said in our February consultation

Under the current charging regime, the income offset is a discount on the cost of a water main or sewer requisition. The approach to calculating the size of this discount is set out in

the Water Industry Act 1991. We proposed to simplify the current approach to calculating the income offset by removing the restrictions on how this discount should be calculated and moving the application of the discount to the infrastructure charge.

Respondents' views

All stakeholders recognised that there are benefits to the proposed change. IWNL especially stated that this proposed change was critical to allowing a level playing field to provide developer services between SLPs, NAVs and the Welsh companies.

However, both the HBF and CCW noted the potential disadvantages of the proposed approach. HBF stated that it did not accept having a reduced income offset for some developers as a result of the change. Persimmon Homes did not raise any concerns with the proposed approach.

Finally, FWC suggested a transition period between the current approach to setting the infrastructure charge and the proposed new charging rule.

Our assessment and decision

As we set out in our consultation document, we anticipate that the proposed change would have the following benefits:

- All customers that make a new connection will be eligible for the discount rather than just those that also requisition a new water main or sewer;
- This would remove the need for the Welsh companies to offer an asset payment to SLPs when they provide a new water main or sewer. This simplifies the process, removing the need for the SLP to rely on information about the size of this discount when providing quotes for these services, thereby removing a barrier to competition on a level playing field; and
- It would provide the Welsh companies with more freedom to decide the appropriate methodology for calculating this discount.

However, some customers may perceive drawbacks to the proposed approach as the total available discount remains the same but would be spread over more customers. This would mean some customers would receive a lower discount than they would have received under the current arrangements.

There may also be cash-flow implications as the proposed discount would be applied to the infrastructure charge, which is due after the new connections have been made, rather than to the requisition charge, for which a deposit is typically required before the water main or sewer requisition will be commenced.

Overall, we do not see a reasonable economic justification to apply the income offset only to developer services that involve a requisition. Connecting any new household premises to an existing water main or sewer will result in a new billable property being connected to the public network. While this could disadvantage some customers that were previously receiving this discount, it will benefit those customers that only require new connections and would not otherwise have received the discount.

We have therefore decided to move the ability to impose an income offset from the requisition charge to the infrastructure charge under the proposed rules.

We note FWC's suggestion of a transition period onto the new charges. As we are proposing to introduce the new charging rules from April 2023 (see section 2 below), we do not propose to include an additional transition period for this specific change.

1.5 Responses to Question 5

Q5: Do you think option 2 or option 3 is the better approach to setting upfront charges for site-specific developer services? Or would you prefer another approach?

What we said in our February consultation

We proposed that under option 2, companies be required where practicable to publish charges or a predetermined methodology for calculating charges. We refer to these as fixed upfront charges, as the charges are not subsequently adjusted on the basis of actual costs incurred.

Under option 3, we would not place any requirement to publish upfront charges for water or wastewater connection or requisition services. Companies would not be prevented from setting upfront fixed charges but they would decide whether to do so, subject to the general charging principles.

We recognise that it is not possible for a water company to provide upfront fixed charges in all circumstances as it requires the water company to have a reasonable basis on which to set such charges, typically by reviewing the costs it has incurred in providing similar services in previous years. In particular, Hafren Dyfrdwy has raised concerns that it does not deliver a large number of developer services to customers and consequently may have too few previous examples of delivering certain developer services upon which to base upfront fixed charges. We also recognise that most site-specific sewerage infrastructure is laid by developers or third parties. This means wastewater companies are unlikely to have a reasonable basis on which to set upfront wastewater charges.

Therefore under option 2 we propose that companies need publish upfront charges for water services only where it is reasonably practicable to do so. And for wastewater services, companies need not publish upfront charges, but they must clearly explain the methodology used for calculating the charges.

Respondents' views

All of the respondents other than the Welsh companies had a strong preference for having a rule requiring fixed upfront charges in the charging arrangements. They note the benefits to customers and to competition of being able to estimate the expected cost of the work without entering into negotiations with the water companies. CCW noted the issues in setting fixed upfront charges for wastewater services and suggested that we consider removing the requirement for setting fixed charges from wastewater requisitions in England as well.

Dŵr Cymru preferred option 3 and noted that it would not prevent the Welsh companies from setting fixed charges if, as a result of the company's consultation with its customers, this was the approach that their customers favoured. However, if its customers preferred an alternative approach to setting charges the water companies, option 3 would provide the freedom to do so.

Hafren Dyfrdwy stated that it plans to set fixed upfront charges where it is practicable to do so. However, it notes that due to its small size, it provides significantly fewer developer services than other water companies. This means it does not have an extensive evidence base of costs from previously provided services on which to base its charges, especially for wastewater services. This will limit its ability to set cost-reflective fixed charges. As a result, it prefers option 3 as it has concerns about its ability to comply with a requirement to set fixed upfront charges.

Our assessment and decision

Stakeholders other than the Welsh companies clearly prefer the charging rules to include a requirement for fixed upfront charges for site-specific services. While there are potential benefits to allowing the water companies to explore other approach in consultation with their customers, and we would encourage them to do so, the strong preference from stakeholders for having such a rule indicates that this is a feature of the charging regime they want to see.

We also understand the point about Welsh companies providing fewer wastewater services than water services, meaning there is likely to be less information on which to base fixed upfront charges for site-specific wastewater services. However, we want to encourage the Welsh companies to provide fixed upfront charges wherever it is practicable to do so.

We have therefore decided to include a charging rule which will require the Welsh companies to set fixed upfront charges for site-specific water and wastewater services, subject to the proposed exemption.

We recognise the concerns raised by Hafren Dyfrdwy around the difficulties that it may face in setting fixed upfront charges for many site-specific services due to the limited number of previously provided services upon which to base such charges. We want to emphasise that the purpose of the proposed charging rule which provides an exemption from the requirement to set such fixed upfront charges is to take into consideration situations such as this (rule 45 in the proposed charging rules under option 2). While we would expect every Welsh company to provide fixed upfront charges for services where it is practicable to do so, we understand that there may be a wider range of circumstances under which a smaller company would not be able to provide reasonably cost reflective fixed upfront charges and that the rule currently at rule 45 in the proposed charging rules under option 2 would apply.

1.6 Responses to Question 6

Q6: Do you think option 2 or option 3 is the better approach to setting charges for requisitions and new connections? Or would you prefer another approach?

What we said in our February consultation

We asked stakeholders whether we should include a charging rule requiring the setting of charges for requisitions and new connections that reflect the costs of providing that specific service. This would still allow the Welsh companies to provide alternative approaches to setting their charges in addition to this. Without such a rule it would allow the Welsh companies to use alternative approaches such as averaged per-plot charges as the only option by which charges are set.

Respondents' views

CCW, FWC, Persimmon Homes and IWNL agreed that Welsh companies should be required to provide the option of charges that relate directly to the costs of providing the service. CCW believed that this approach is beneficial for smaller developers as it will result in more cost-reflective charges, while larger developers will see the benefits of having transparent charges. IWNL pointed to the benefits of aligning the approach with that of England for organisations that operate on both sides of the border. FWC had concerns about any charging rules that allow for averaged charges due to the potential to make it harder for SLPs to compete for some sites.

The HBF, Hafren Dyfrdwy and Dŵr Cymru did not want Welsh companies to be required to provide the option of charges that relate to the costs of providing the specific service. Not having this requirement would allow for averaged per-plot charging as the main way to set site-specific charges. The HBF said this would provide certainty over charging but noted that there would have to be transparency over how such charges were calculated. Hafren Dyfrdwy said that it was planning to set charges on the basis of the cost of providing the services but preferred the option of being able to set charges on an alternative basis if necessary. Dŵr

Cymru said having the option to base its charges on the cost of providing the service or another approach would enable it to align charges with its customers' expectations and give it the flexibility to incentivise good outcomes for customers, communities and the environment.

Our assessment and decision

Alternative approaches to setting charging structures such as an averaged per-plot charge will inevitably include a number of winners and losers where the actual site-specific costs of the works are higher or lower than the averaged per-plot charge. While this may average out for larger developers that build many developments, customers that only require a single service or a small number of services may face charges that are well above or below the cost of providing the developer service.

Allowing the Welsh companies to only offer charges that are not based on site-specific costs has the potential to raise competition concerns as SLPs and NAVs may not be able to compete on a level playing field for some services if the charges offered by the Welsh companies do not directly relate to the costs of providing the service to the customer. Requiring the Welsh companies to set charges which relate to the costs of providing each service would not prevent them from providing alternative charging options in addition to this.

On balance, **we have decided to include a rule that would require the Welsh companies to provide the option of paying set requisition and new connection charges that relate to the costs of providing that specific service.**

1.7 Responses to Question 7

Q7: Are there any charging rules that have been included under options 2 or 3 that are not required due to the general requirements of the charging principles?

What we said in our February consultation

We asked stakeholders if there were any proposed charging rules which could be removed on the basis that they would be duplicating requirements already existing in the general charging principles.

Respondents' views

FWC did not want any of the rules to be removed and highlighted the general benefits of having specific charging rules. It stated that having specific charging rules allows stakeholders to reference the specific requirements of the rules rather than relying on charging principles which are more subjective. Relying on general charging principles could

lead to a number of disputes being referred to Ofwat to clarify the interpretation of the principles.

Dŵr Cymru pointed out a number of potential issues with the proposed charging rules:

- The proposed rule 29 under option 2 could disincentivise undertakers from upsizing assets to take account of future developments. The proposed rule requires a proportional capacity split between the requirements of the initial development and future developments. As a result, the developer would only pay a proportion of the costs of an upsized asset and the risk of the rest of the capacity going unused is then placed on either infrastructure charges or other developer customers.
- Dŵr Cymru requested that Ofwat reviews sections 51A and 112 of the Act (relating to adoptions of water mains and sewers) to ensure the new charging rules provide a consistent approach. Specifically, to ensure that the Welsh companies are not prevented from requiring a reasonable surety or bond to be placed when making an agreement to adopt a new water main or sewer. The current wording of the proposed charging rule (rule 43 under option 2) would only instruct the Welsh companies to consider “...risk to be borne by the undertaker in carrying out the work in question.” Dŵr Cymru suggested expanding this definition to include the risks to the undertaker of works being undertaken by a third party.

Our assessment and decision

Apportionment of the costs of additional capacity

When a water company provides a requisition, it may identify benefits in providing a larger new water main or sewer than is immediately required if, for example, it expects further growth and new developments in the area. By providing a water main or sewer that would supply all of the current and anticipated needs of the area, it can make savings compared with providing one asset to serve the immediate needs, and another later to serve future needs. However, there is a risk that the additional development in the area does not take place and the additional capacity is not needed.

Our proposed approach aims to place a balance between removing barriers to the provision of additional capacity where it is needed and disincentivising the provision of speculative additional capacity that may not be needed.

Under our proposed approach, the customer that makes the requisition would not incur any additional charges if the Welsh company provides more capacity than the customer has requisitioned. The customer would only be required to pay for the proportion of the capacity that they require as the rest of the capacity is anticipated to be used by the additional unrelated developments in the area. In most cases, the provision of upsized infrastructure typically results in a smaller cost per unit of capacity provided, so the customer that makes the requisition is likely to pay less than if the upsizing was not undertaken. This is reasonable

as the customer that makes the requisition should also benefit from this lower cost per unit of capacity provided.

The rest of the costs would be considered as offsite network reinforcement works and would therefore be recovered through infrastructure charges.

Finally we note that this rule does not apply where the use of standardised sizes of pipes and other components results in incidental additional capacity being created which is greater than required for the requisition. When water companies provide new water mains or sewers to supply a development, they will typically use standard size pipes and other components rather than obtaining pipes and components that provide exactly the capacity that is required by the development. This is because it is typically cheaper to purchase a slightly larger pipe or component of a standard size than to purchase a bespoke pipe that provides exactly the amount of capacity required by the development. This will result in some amount of additional capacity being provided above that which is needed by the development, but will be cheaper to provide and therefore reduce the charges to the customer. In such a situation, all costs should be covered by the Requisition Charge.

Sureties and bonds for adoption agreements

We consider that the issue raised by Dŵr Cymru is reasonable. As a result we think it is appropriate to amend the proposed rule to add the text highlighted in red.

43. The type and amount of security should not be unduly onerous, taking into account the risk to be borne by the undertaker in carrying out the work in question **or, in the case of adoption agreements under section 51A or 104 of the Water Industry Act 1991, take into account the risks borne by the undertaker of the work in question being carried out by a third party.** The type and amount of security and the payment of interest on the security, where Undertakers require security, should reflect the general charging principles set out in paragraph **Error! Reference source not found..**

1.8 Responses to Question 8

Q8: Are there any additional charging rules that should be included under options 2 or 3?

What we said in our February consultation

We asked if there were any other charging rules that stakeholders wanted us to include that were not in the proposed charging rules.

Respondents' views

IWNL commented that rule 27(i)(f) of the Charges Scheme Rules, as we propose they be amended, specifies that English companies charges should reflect ‘transparency and customer-focused service’, while the equivalent principles for Welsh companies only includes a reference to transparency. IWNL believes there would be merit in including a principle of ‘customer-focused service’ in the Welsh charging rules.

FWC suggested that the charging rules on agreements under Section 51A or 104 of the Act should explicitly cover the situation where an SLP delivers the scheme that provides capacity in addition to that which is required by the newly connected premises on that development. The rules should make it explicit that the SLP should be paid for the additional installation costs they incur.

FWC also raised concerns that the proposed option 3 would remove many charging rules which should be included to achieve a reasonable balance between companies and their customers.

Our assessment and decision

The principles we included in rule 27 of the proposed charges scheme rules have been taken from the sets of charging guidance to Ofwat that were issued by Defra and Welsh Government respectively. As a result, we believe that it is appropriate for the general principles that apply for Wales and England to reflect the guidance issued to us by the relevant government. These principles should drive the Welsh companies towards providing a customer-focused service even though there is not a specific principle of customer-focused service.

We do not think a specific charging rule is required to address FWC’s point about an SLP, with the agreement of the Welsh company, providing additional capacity as part of the provision of a new water main or sewer. The charging rules already include requirements to set charges that are fair, transparent and cost reflective. When entering an adoption agreement under section 51A or 104 of the Act, the Welsh companies should ensure that the agreement sets out whether the party building the assets to be adopted will be providing additional capacity above that which is required by the premises that will be connected to the adopted infrastructure and any associated payments.

1.9 Responses to Question 9

Q9: What are your views on the three proposed options? Which of the options do you prefer? Would you prefer another approach?

What we said in our February consultation

We asked for stakeholders’ general views on the three proposed options of setting charging rules.

Respondents' views

All of the respondents other than the Welsh companies favoured option 2. None of the respondents favoured retaining the status quo (option 1).

- CCW said that option 2 allows water companies flexibility to set fair charges, provides clarity to those working across the border and places emphasis on customer consultation. Option 3 may not provide sufficient transparency for developers.
- IWNL, the HBF and Persimmon Homes commented on the certainty that option 2 brings for developers and other providers of developer services.
- FWC suggested that option 3 should be discarded as it would put providers of developer services other than the Welsh companies at a significant disadvantage.
- While the HBF preferred option 2, it suggested that thought should be put towards ensuring that innovative approaches by the Welsh companies were allowed, especially where they can reduce costs to customers.

Hafren Dyfrdwy said that it is looking to align with the requirements of the charging rules under option 2, but has concerns about whether it will be practicable to do so, as discussed in sections 1.3, 1.5 and 1.6 of this document. As a result it preferred option 3.

Dŵr Cymru considered that only option 3 would provide the Welsh companies with the flexibility required to meet customers' expectations.

Our assessment and decision

Based on the responses to this question and the previous questions, we think that the appropriate approach will be to base the charging rules on those set out under option 2 in the consultation document. The majority of the respondents have a clear preference for this option. We will also make a number of changes to the proposed charging rules under option 2 as described in the previous sections of this document. We think that these changes will address the majority of the concerns raised by Hafren Dyfrdwy regarding the practicability of it complying with the proposed rules under option 2 and several of the other issues raised by the other stakeholders.

1.10 Response to Question 10

Q10: Are there any other issues we should consider as part of our assessment of the impacts of introducing the proposed charging rules?

Respondents' views

All respondents apart from Dŵr Cymru and Persimmon Homes did not comment on the timing of the introduction of the proposed charging rules. Persimmon Homes said the proposed

timeline appeared too ambitious. Dŵr Cymru had several concerns around the proposed timing of the implementation of the charging rules, which we address in section 2 below.

Hafren Dyfrdwy thought that the impact assessment underestimated the differences between option 2 and 3, with option 2 imposing a large regulatory burden due to requirements such as the need for Welsh companies to consult with stakeholders on proposed charging arrangements.

FWC suggested that the requirement to provide worked examples that has been included in England through our annual information notice⁴ has been beneficial and this requirement should be included in the Welsh charging rules.

Our assessment and decision

We understand that the proposed charging rules under option 2 would place a higher regulatory burden on the Welsh companies than those under option 3. The effect of this would be felt more keenly by Hafren Dyfrdwy than by Dŵr Cymru, as the implementation costs (for example stakeholder consultation) are, in part, fixed irrespective of the size of the company and therefore proportionately greater for smaller companies. In order to reduce the regulatory burden on Albion Eco and any other NAVs that may operate in Wales, the proposed rules provide NAVs with exemptions to many of the proposed charging rules as the requirements would be disproportionate when compared to the size of a NAV's typical customer base.

We still think it is necessary to retain the proposed requirement for the Welsh companies to undertake consultation on their charges. The responses from several stakeholders highlight the value they place on this process. We consider this to be a core feature of the charging regime to ensure companies deliver for their customers and meet their expectations. However, we recognise the legitimate concern around the size of the regulatory burden on a company of the size of Hafren Dyfrdwy. While we expect the Welsh companies to undertake meaningful consultation with their stakeholders when developing their charges, it may be reasonable for smaller companies to do so on a smaller scale. The proposed rules allow each company to decide the appropriate approach to take when consulting with its customers and we will recognise the relative size of the customer base when considering compliance with this charging rule.

Finally, we agree that there are potential benefits to including a charging rule that places a requirement to set out worked examples in the Welsh companies' charging arrangements.

⁴ [IN-2007-Information-notice-on-charging-information-requirements-2021-22.pdf \(ofwat.gov.uk\)](#).

2. Decision to defer introducing the new charging rules until April 2023

What we said in our February consultation

We said that, if appropriate, we planned to undertake a statutory consultation in spring 2021 on the final charging rules, to come into effect in April 2022.

Respondents' views

Dŵr Cymru was concerned with the proposed timing of the introduction of the new charging rules, and suggested there would be benefits in delaying the introduction:

- Dŵr Cymru believes that a 12-month period should be allowed between the final rules being published and the rules coming into effect to allow the time for the water companies to engage meaningfully with all relevant stakeholders in the development of their charging arrangements. It would also provide the opportunity for Ofwat to undertake additional stakeholder engagement on the proposed changes.
- It noted that, during the summer of 2021, we are planning to undertake a review of the developer services charging rules that apply in England. It suggested that, given the benefits that we have pointed out previously of having a broadly similar charging regime in England and Wales, there would be benefits in applying any relevant lessons that are learnt from the review of the English charging rules to the Welsh charging rules. This would not be possible if the charging rules in Wales were introduced to come into effect in April 2022.
- It noted the potential benefits of aligning the introduction of the new charging rules to align with the implementation of the relevant parts of the Wales Act of 2017. This would avoid a situation where the affected customers would go through multiple changes in the applicable charging regime in quick succession.
- Dŵr Cymru said there could be unintended consequences for water companies from changing the basis of how charges for developer services are set during a price review period.

As a result of these issues, Dŵr Cymru suggested an implementation date of 1 April 2025.

Persimmon Homes also commented that the proposed timescales appeared to be too ambitious.

Our assessment and decision

We recognise there is a balance between the benefits of introducing the new charging rules early, and the benefits of allowing more time for the water companies to undertake meaningful consultation with their stakeholders on their proposed charging arrangements.

We want to introduce new charging rules to address known issues with the current charging arrangements, such as the concerns around potential double-charging of reinforcement works. However we need to ensure that the Welsh companies have sufficient time to undertake the development of these new charging arrangements in consultation with their stakeholders.

We also note that while the new charging arrangements would not have come into effect until 1 April 2022, the water companies would in practice have had to finalise their charging arrangements earlier than this, due to the need to publish the charging arrangements at least two months before they came into effect.

However, we are not convinced that the benefits of delaying the introduction of these charging rules until April 2025 outweighs the benefits to stakeholders of introducing the rules at an earlier date. While the new charging rules will impact the charges that the water companies set for their developer services, the rules include a requirement for the balance of charges between developers and existing customers to be broadly maintained. As a result, we do not anticipate any significant changes in the amount of revenue that the Welsh companies can recover for the provision of developer services. We also note that the PR19 price review includes reconciliation processes to take into account any potential over or under recovery of revenue. As there is not specific concern about a particular issue, just the potential for such an issue to arise, we do not agree that there is sufficient reason to consider delaying the introduction of the new charging rules until April 2025.

We have therefore decided, in consultation with the Welsh Government, that we will not aim to introduce the new charging rules for developer services in Wales on 1 April 2022 as this will not provide the Welsh companies with the time they need to develop and consult on a new set of charging arrangements.

We are therefore planning to introduce the new charging rules for developer services in Wales to come into effect from 1 April 2023.

3. Next Steps

We are planning to introduce the new charging rules with effect from 1 April 2023. We will undertake a statutory consultation on the final proposed charging rules in autumn 2021 and issue the charging rules in early 2022. This will provide the Welsh companies with a year to prepare and finalise their charges for 2023-24.

We will need to modify Welsh companies' Instruments of Appointment ("licences") to remove the charging rules relating to infrastructure charges that are currently in these licences. We will undertake the licence modification process during 2022. More details of this proposed licence change can be found in our February consultation.⁵

We have recently consulted on a number of improvements to the charging rules for developer services in England.⁶ We will consider the responses to that consultation and, where appropriate, we may propose similar changes to the charging rules for developer services in Wales.

⁵ [Consultation on new connections charging rules for Welsh companies - Ofwat.](#)

⁶ [Consultation on updating Ofwat's charging rules - Ofwat](#)

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

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA
Phone: 0121 644 7500

© Crown copyright 2021

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to mailbox@ofwat.gov.uk.

OGL