

August 2021

# Statutory consultation on changes to our charging rules

Ofwat

## About this document

This document summarises the changes we propose to make to our charging rules under the relevant sections<sup>1</sup> of the Water Industry Act 1991 (**the Act**) as amended by the Water Act 2014. We [consulted on these proposed changes in June 2021](#). This document also sets out responses to that consultation and our decisions in the light of the responses received. We have [published responses](#) to the June consultation on our website.

We are consulting on draft rules, with proposed amendments identified, and the document entitled Common Terms and Worked Examples – English New Connections Rules which we propose to issue under rules 11 and 12. This statutory consultation is the formal, final step before we issue revised rules, to take effect from **1 April 2022**, which we issue under the Act.

Specifically, we are consulting on wording changes to the:

- [Wholesale Charging Rules](#);
- Charging Rules for New Connection Services (English Undertakers) ([English New Connection Rules](#)); and
- [Charges Scheme Rules](#).

The changes we propose to implement relate to water and / or wastewater companies wholly or mainly in England (**English companies**) and, other than where specified, to companies wholly or mainly in Wales (**Welsh companies**)<sup>2</sup>.

These changes are to make important steps to improve the transparency of charges for new connections set by English companies, specifically through greater consistency in terminology and through use of worked examples. Companies have collaborated to make these improvements under the leadership of Northumbrian Water and Water UK, and with input from stakeholders. They follow from our [November 2020 conclusions on new connections](#).

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<sup>1</sup> We consult on changes to the Wholesale Charging Rules under sections 66EB and 117K; changes to the English New Connection Rules under sections 51CE, 105ZG and 144ZB; and changes to the Charges Scheme Rules under section 143.

<sup>2</sup> These include NAVs. Unless otherwise specified or it is clear from the context, for ease in this document a reference to "companies" is to English companies, Welsh companies and NAVs.

There are also clarifications and minor updates to our rules, reflecting feedback we have received from companies and other stakeholders since we last updated them.

## Responding to our statutory consultation

**The closing date for this consultation is 1 September 2021.** Please email us at [charging@ofwat.gov.uk](mailto:charging@ofwat.gov.uk) with your response, or if you wish to discuss any aspect of this consultation, or to arrange a conversation on the issues we have raised.

We may publish responses to this consultation on our website, unless you indicate that you would like your response to remain unpublished. Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with access to information legislation – primarily the Freedom of Information Act 2000 (**FoIA**), the General Data Protection Regulation 2016, the Data Protection Act 2018, and the Environmental Information Regulations 2004. For further information on how we process personal data please see our [privacy policy](#).

If you would like the information that you provide to be treated as confidential, please be aware that under the FoIA there is a statutory [Code of practice](#) which deals, among other things, with obligations of confidence. In view of this, it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on Ofwat.

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# 1. Summary

## 1.1 This consultation

Ofwat sets principle-based charging rules which give companies flexibility to innovate in how they calculate and present their charges and offer better customer services. Having the ability to set rules means we can monitor developments and respond to them accordingly and resolve potential breaches of our rules by issuing enforcement directions.

This document sets out the changes we propose to make to our charging rules under the relevant sections<sup>3</sup> of the Water Industry Act 1991 (**the Act**) as amended by the Water Act 2014. We consulted on these proposed changes in June 2021. This document also sets out responses to that consultation and our decisions in the light of the responses received. We have published responses to the June consultation on our website. This statutory consultation is the formal, final step before we issue revised rules, to take effect from **1 April 2022**, which we issue under the Act.

Specifically, we are consulting on changes as highlighted in the following draft rules:

- [Draft Wholesale Charging Rules](#);
- [Draft English New Connection Rules](#);
- [Draft Charges Scheme Rules](#); and
- [Draft Common Terms and Worked Examples – English New Connection Rules](#).

These changes are to make important steps to improve the transparency of charges for new connections set by English companies, specifically through greater consistency in terminology and through use of worked examples. Companies have collaborated to make these improvements under the leadership of Northumbrian Water and Water UK, and with input from stakeholders. They follow from our [November 2020 conclusions on new connections](#).

There are also clarifications and minor updates, reflecting feedback we have from companies and other stakeholders since we last updated the rules.

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<sup>3</sup> We consult on changes to the Wholesale Charging Rules under sections 66EB and 117K; changes to the English New Connection Rules under sections 51CE, 105ZG and 144ZB; and changes to the Charges Scheme Rules under section 143.

There are separate developer services charging regimes for companies wholly or mainly in England (**English companies**) and companies wholly or mainly in Wales (**Welsh companies**). In this document we consult on issues of relevance to both.

We [consulted on these proposed changes in June 2021](#), and received 24 responses, from a range of stakeholders. We have taken careful account of responses when deciding on our final proposals. We are grateful to all respondents for their contributions.

We will keep our rules under review, to reflect our thinking and decisions on the 2024 price review (**PR24**), to reflect any changes to legislation or have regard to guidance and other relevant policy of the UK Government and Welsh Government.

## 1.2 Wider work on developer services

This consultation fits into a wider programme of work on charges for and regulation of developer services, notably:

- our April 2021 consultation on [the scope and balance of developer charges and incentives](#);
- further analysis of companies' costs and charges for new connections, including a report, [prepared by SIA Partners](#), on variations in companies' charges for new connection services;
- work [prepared by CEPA](#) alongside our May 2021 PR24 discussion document, that identified two options for how we might regulate developer services at PR24;
- our June 2021 [proposals to collect additional data](#) to support our consideration of the options identified by CEPA; and
- our June 2021 consultation on improving the consistency of [overhead cost reporting](#), including for developer services, which we consider to be relevant to the setting of charges.

## 1.3 Structure of this document

The rest of this document is structured as follows:

- In chapter 2 we summarise responses to our June consultation and our decisions on the changes we proposed;
- In chapter 3 we summarise responses to our clarification of the rule for setting infrastructure charges;
- In chapter 4 we set out next steps.

## 2. Consultation responses

### 2.1 Summary

We received 24 responses to our consultation and are grateful to all respondents for their input. We include a full list of respondents in Table 1 and have [published the responses on our website](#).

**Table 1 – Respondents to our June consultation**

| Water and wastewater companies |                            | NAVs, SLPs and developers <sup>4</sup> | Consultants and other respondents        |
|--------------------------------|----------------------------|--|--|
| Affinity Water                 | Sutton & East Surrey Water | Barratt Homes                          | Consumer Council for Water (CCW)         |
| Anglian Water                  | Southern Water             | Independent Water Networks (IWNL)      | Fair Water Connections (FWC)             |
| Bristol Water                  | Thames Water               |  | Home Builders Federation (HBF)           |
| Northumbrian Water             | United Utilities           |  | Technical and Development Services (TDS) |
| Portsmouth Water               | Wessex Water               |  | Vistry Group                             |
| Severn Trent                   | Welsh Water                |  | WA Consultancy                           |
| South East Water               | Yorkshire Water            |  | Water UK                                 |
| South Staffs Water             |                            |  |  |

Respondents were broadly in favour of all of our proposed changes, although not every respondent commented on every proposal, and some objected or offered alternatives.

We summarise our proposed changes in Table 2, which takes account of responses received to our June consultation (represented by text in red font). Each column refers to one of the three sets of charging rules. If a proposed amendment appears in more than one column, it applies to each set of charging rules.

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<sup>4</sup> A NAV is a company that has been granted an appointment by Ofwat to become the statutory provider of water and / or sewerage services for a geographic area, replacing the existing water or sewerage appointee. Companies without an existing appointment become new appointees; those with existing appointments have theirs varied. Hence we refer to them as New Appointees or Variations, or NAVs.

An SLP (or Self Lay Provider) is not an appointee but an accredited, specialist provider of water pipes and associated infrastructure and services in accordance with agreements with water companies made under section 51A of the Water Industry Act 1991.

In section 2.2, we summarise consultation responses for each proposed change, and explain our decisions on how to proceed.

**Table 2 – Summary of proposed changes to charging rules**

|   | Wholesale Charging Rules (WCR)   | Charges Scheme Rules (CSR)  | English New Connection Rules (ENCR)   |
|---|--|---|---|
| 1 | Change the publication deadlines required by the WCR to "by 13 January", and for CSR and NCR to "by 1 February". <del>Change all publication deadlines to specific dates, for all companies (including small companies). Remove requirement (WCR A2) on companies to publish scope of possible significant changes to primary Wholesale Charges.</del> |   |   |
| 2 |  | Amend to allow simultaneous publication of statement of significant changes and charges scheme.   |   |
| 3 |  |   | <del>New general charging principle that charges should reflect relevant costs rule that "Charging structures must reflect the long run costs associated with providing the relevant service"</del>   |
| 4 | Amend glossary to reflect outputs from industry working group on terminology. <del>New, separate document to contain common terms not used in or required for interpretation of the English New Connection Rules</del>   |   |   |
| 5 |  |   | <del>New information requirements on using worked examples to illustrate charges for new connections, plus amended scenarios and standardised format for presenting examples. New, separate document to contain worked examples and standardised format</del> |
| 6 |  | Move rules relating to English companies' Infrastructure Charges <del>and Income Offsetting</del> so that they appear in the same document as the English New Connection Rules rather than in the Charges Scheme Rules document |   |
| 7 |  | Amend definition of "income offset" to be clear that it applies to new connections to both existing mains and new mains   |   |
| 8 |  |   | Amend definition of "network reinforcement" to be clear that the rules allow companies to take into   |

|   |  |  |   |
|---|--|--|---|
|   |  |  | account costs incurred as a result of new premises connected by a bulk service NAV <sup>5</sup>   |
| 9 |  |  | New rule requiring companies to explain how they treat quotes that cross into a new charging year |

## 2.2 Responses to our proposed changes

We explained in our June consultation why we are proposing the changes to our rules.

We set out the rationale for each change in detail, and asked the following questions:

Q1: Do you agree with our proposed rule changes? Please offer alternatives if you think they would better achieve our intentions.

Q2: Do you agree with our proposed changes in Appendices 1, 2 and 3?

In the rest of this section we summarise the responses to each proposed change and our decision on the way forward.

### 2.2.1 Changing publication dates

#### What we said in our June consultation

Our charging rules require companies to publish their charges according to specific but different rules. Our proposal is to align publication of Charges Schemes and Charging Arrangements "by 1 February" (except for small companies, for which the date would be "by 1 March"), and Wholesale Charges "by 13 January". The earlier date for Wholesale Charges is to give Retailers time to set retail charges by 1 February.

#### Respondents' views

Respondents were in favour of our proposal, noting that it would improve clarity.

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<sup>5</sup> A bulk service NAV is one that is served by an incumbent through a bulk supply agreement and / or a bulk discharge agreement.

- Bristol Water, United Utilities, and Welsh Water commented on the dates for publishing indicative wholesale charges – both the scope for possible changes (current publication being "no later than 6 months before publishing final Wholesale Charges") and the indicative wholesale charges ("no later than 3 months before" final charges are published).
  - Bristol Water said it would prefer the notification of potential changes to be at the same time as publication of indicative charges (October) because the current July deadline is too close to prior year reporting to give any meaningful update as to possible charges in the following year.
  - United Utilities and Welsh Water said they would prefer specific dates, and Welsh Water added "by 13 July" for the scope of possible changes and "by 13 October" for indicative wholesale charges.
- Barratt Homes, HBF and Vistry Group said all publications should be published on 1 February, for the sake of consistency and transparency.
- Some respondents commented on the application of this proposal to small companies and new appointees.
  - IWNL said Ofwat should review the obligations on new appointees, as the time currently available to them to review incumbent tariffs and setting their own is short.
  - Yorkshire Water said Wholesale Charging Rule 26 should be "updated" to allow Retailers enough time to review new appointee wholesale charges and set their own charges for business customers served by new appointees.
  - WA Consultancy said small companies should also publish on 1 February.
- Barratt Homes and HBF commented on the need for companies to explain differences between forecast and actual charges.
- FWC noted that companies need to ensure they publish by these dates.

## Our view

There is clear support from stakeholders for publication deadlines to be specified. We agree this would improve clarity and propose to specify dates throughout the three sets of rules to all requirements to publish charges information, including for small companies and new appointees. We expect all companies to publish by these dates.

We do not agree with the comment that all documents should be published on 1 February. Wholesale charging arrangements need to be published earlier to give Retailers time to publish their retail charges by 1 February. And small companies are usually required by their licence to set charges that are not greater than the charges set by the regional incumbent water company. This means they cannot set their charges until after the relevant incumbent company has published its charges.

The comment by Barratt Homes and HBF about explaining differences in indicative and final charges appears to relate to wholesale charges, for which there is an existing

requirement<sup>6</sup> in the Wholesale Charging Rules to do this in relation to significant differences. There is no requirement on companies to publish indicative new connection charges.

We are persuaded by Bristol Water's case for removing the current requirement in rule A2 of the Wholesale Charging Rules that incumbents publish the scope of proposed significant changes to primary Wholesale charges in July each year. As Bristol Water pointed out, in July the water companies may not yet be in a position to provide a meaningful update on the likely charges that will come into effect in April the next year. In practice, these published documents have typically contained little specific information on the likely charges for the next year. Instead they typically summarise the expected drivers of potential changes to the charges, such as ongoing changes in charging policy over many years and the expected impacts of our annual price limits. This publication date is also before our annual in-period reconciliation process takes place, which can adjust the amount of revenue that a company can collect from its customers in the following year.

Removing the requirement to publish in July does not mean water companies should ignore the needs of Retailers operating in their areas. For example, if a water company identifies possible significant changes to its wholesale charges well in advance of its October deadline to publish charges, we expect water companies to proactively engage with Retailers and other key stakeholders and consider handling strategies. Publishing indicative charges in October should be only one aspect of water companies' stakeholder engagement.

## 2.2.2 Publishing Statements of Significant Changes

### What we said in our June consultation

In the Charges Scheme Rules, companies (with the exception of NAVs) are required to publish a statement confirming whether they anticipate any significant changes in customers' bills or their charging policies, compared with the preceding year. They must publish this statement "at least three weeks before the publication of the charges schemes." We propose to amend the rule to allow simultaneous publication at least three weeks before the deadline for publishing charges schemes. This proposed change does not affect the continuing obligation for companies to consult Consumer Council for Water about their proposed charges schemes in a timely and effective manner.

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<sup>6</sup> Requirement A1(e).

## Respondents' views

Respondents were in favour of our proposal, with some respondents suggesting fixing the date for publication, rather than leaving it defined as "three weeks before publication of Charges Scheme".

- Bristol Water noted the proposed definition equates to a fixed date of 11 January for Wholesale charges, but said it would prefer the publication deadlines to be "by 13 January", to align with the publication deadline for Wholesale Charges. This would simplify its assurance and governance arrangements.
- Bristol Water also said the benefit of publishing statements of significant changes together with charges schemes (when there are no significant changes to report) is only realised if both documents could be published on 1 February (the deadline for publishing charges schemes) instead of 13 January.
- Welsh Water suggested "by 11 January".
- Affinity Water suggested the change but offered no date.
- TDS and WA Consultancy said statements of significant change should be published on 1 February, to increase transparency.

## Our view

There was strong support for our proposal to allow simultaneous publication of charges schemes and statements of significant changes. We will amend our rules as previously proposed.

We agree with the suggestion that fixing dates for all publications would improve clarity, and we note in section 2.2.1 of this document our proposal to achieve this.

We will fix the publication date for statements of significant changes to be no later than 1 February for new connection services, but 13 January for charges schemes. We do not see how delaying the publication of statements of significant changes to 1 February would increase transparency.

### 2.2.3 Cost reflectivity

#### What we said in our June consultation

We propose to introduce in the English New Connection Rules a new rule that "Charging structures must reflect the long run costs associated with providing the relevant service." We believe it is sensible for this new principle to be consistent with the existing principle in the Wholesale Charging Rules and Charges Scheme Rules.

## Respondents' views

There was a mixed response from respondents to this proposal. There was strong support for the principle that charges should be cost-reflective, but there was some concern about how this proposed rule would be applied in practice, and some respondents wanted more detail.

- Anglian Water said it would be helpful to define each service for which charges are to be cost-reflective, and to apply the requirement individually.
- Affinity Water commented that defining the timeframe for cost-reflectivity would help when considering potential tensions with the principles of stability and predictability. On the other hand, Yorkshire Water said the proposed rule gave some clarity to companies while allowing them flexibility to choose the appropriate time frame to assess costs based on their own expenditure profiles and cost drivers.
- Barratt Homes, FWC, HBF, IWNL, Portsmouth Water, Thames Water, Vistry Group, WA Consultancy and Wessex Water asked for a definition of "long run costs". United Utilities assumed "long run" does not mean "marginal costs" but an appropriate allocation of costs including fixed and capital costs.
- TDS referred to the work carried out by Ofwat and subsequently with SIA Partners on variances in companies' charges for new connection services. TDS also asked what the proposed rule means.
- Wessex Water made the point that cost-reflectivity should not prevent companies from offering upfront fixed tariffs, which benefit some customers.
- Severn Trent said the approach to setting infrastructure charges based on the five-year rule conflicts with the proposed rule, because a five-year period will not represent the long run costs of reinforcement.
- Southern Water expressed concern that applying the proposed rule to contractors might require renegotiation of contractor rates, which would be expensive. It also suggests Ofwat should carry out an impact assessment on the proposal. Southern Water also queries whether there is any practical difference between short-run and long-run costs for on-site assets.

## Our view

Cost-reflectivity is important, and we welcome that respondents recognise this. We also acknowledge that accepting a principle and applying it in practice can be two different things. We recognise that some companies and other stakeholders would prefer more detail from Ofwat on how the rule should be applied. We also note that some companies have raised no concerns with applying the rule as currently proposed.

Our charging rules are deliberately less rigid than the framework previously set out in the Act. We designed our rules to give companies more ownership of their charges and

more scope to apply the rules based on their own circumstances, a point recognised by Yorkshire Water. Affinity Water makes an important point about the interaction between different charging principles and the need for companies to apply the rules in a balanced way. We know that stakeholders benefit from charges that are stable and predictable and we do not want to disrupt how companies set charges that balance these principles.

Also, defining "long run costs" could stifle companies' approaches to setting charges, which Wessex Water notes in relation to upfront fixed charges. We do not want to reduce benefits to customers or constrain companies' ability to respond to their needs. Neither do we want our rules to cause companies to incur unnecessary expenditure, as Southern Water noted could happen, or create conflict between different charges, as alluded to by Severn Trent. We note, however, that it is for companies to decide how best to comply with our rules.

Southern Water makes an interesting point about the difference, if any, between short-run and long-run costs for on-site new connection services. Portsmouth Water makes a similar point that a company's costs are not influenced by long run factors. We chose the wording in our proposal to be consistent with the existing cost-reflectivity rule in the Wholesale Charging Rules and Charges Scheme Rules, which both refer to long-run costs. However, we recognise that such alignment may be less important than ensuring each set of rules is appropriate for the activities they cover. For developer services, charges for on-site services are less influenced by long run factors than could be said for wholesale charges or household charges, although it is important that charges for new connection services are cost-reflective.

Therefore, taking careful account of the comments made by respondents, including the strong support for cost-reflectivity as a principle, we propose that cost-reflectivity is included as a new, general charging principle, but without reference to a specific timeframe. Having this new general principle also highlights the importance of striking the right balance between cost-reflectivity and the other charging principles, such as stability and predictability.

We are grateful to companies for their involvement in the work by SIA Partners examining the variation in charges for new connection services. We publish the report, for information, alongside this document. We expect companies to use the information published in this report in setting their new connection charges for 2022 and beyond, using the principle of cost-reflectivity, along with the other principles in our charging rules including those of stability and predictability.

## 2.2.4 Consistent terminology

### What we said in our June consultation

In our [November 2020](#) conclusions document on charging arrangements for new connection services, we encouraged companies, Water UK and other stakeholders to take forward work on improving consistency in terminology. We are pleased that companies, supported by Water UK, have developed a draft set of terms. We look to each company to actively engage with stakeholders in its region to discuss these draft terms, during this consultation period, and use it as an opportunity to ensure their responses to this consultation are as robust as possible. We propose to require use of the terms in charging arrangements under our rules, depending upon the feedback from stakeholders in this consultation.

### Respondents' views

All respondents except one were in favour of improving consistency between companies in how they use terms in their charging publications, particularly for new connection services, and with the proposed amendment requiring use of the agreed terms. Some respondents made additional comments.

- Water UK submitted a comprehensive list of definitions, including comments received from some stakeholders. Some companies noted their involvement in the industry working group.
- Bristol Water said it would engage its SLP and developer stakeholders about the standard terms and feed back any suggestions they make. Yorkshire Water and United Utilities said they will continue to engage their customers, and both Yorkshire Water and Water UK offer to continue to discuss terms where there remain differences of view.
- Portsmouth Water said its stakeholders wanted a rule to require companies to use standard terms; any changes in companies' use of terms to require approval by Ofwat and customer support; and more terms to cover all aspects of connections charging.
- United Utilities noted that charges and charges structures remain the responsibility of companies' Boards and use of standard terms should not impair that responsibility.
- FWC, IWNL, Northumbrian Water, TDS, United Utilities, Vistry Group and WA Consultancy proposed alternative definitions for some terms.
- Barratt Homes, HBF and Vistry Group repeat their request for a definition of "long run costs".
- TDS did not ascribe much value to the work and commented that the issues are not complex.

## Our view

The sector has made good progress towards an agreed set of terms, led by Northumbrian Water and Water UK. With so many stakeholders involved, of different types and sizes and in different locations, and with the market continuing to evolve, it is unlikely that there will ever be consensus across all terms. However, companies and other parties have strived for as much consistency as possible and we welcome what they have achieved so far. Furthermore, one of the benefits of Ofwat's ability to set charging rules means the sector can keep under review how companies present their services and propose further standardisation of terms in the future.

We have carefully considered the definitions proposed by stakeholders. We support the point made by United Utilities that companies (and their Boards) need to retain ownership of their charges and continue to ensure how they present charges has customer support. We also acknowledge its point that standard terms may be defined with language that is less commonly used by its customers. We remind companies that we define terms primarily for the purpose of interpreting our charging rules and that companies can and should present their charges with as much detail as is helpful to their customers.

In terms of the points made by Portsmouth Water, our proposal includes a requirement on companies to use our standard terms, where appropriate. But we do not think it is necessary or desirable to require companies to seek approval if they wish to use additional language or include additional terms in their charging documents.

We welcome the commitment by some companies to ongoing discussion and engagement with their stakeholders, and encourage all companies to regard this work as an ongoing process, not a one-off exercise. We are keen to facilitate efforts, if that would be helpful, including providing further support to the working group, particularly where there remain differences of view.

Our charging rules define terms in order to aid the understanding and interpretation of the rules. There are 25 defined terms in the English New Connection Rules, and fewer terms defined in the Wholesale Charging Rules and Charges Scheme Rules. However, there are more than 100 terms considered by companies and stakeholders, many of which are likely to be used by companies in their charging publications and engagement with customers, but do not appear in our charging rules. We support efforts by companies to improve consistency in their use of language and companies, stakeholders and Ofwat shares the view that it would be sensible for us to require companies to use common terms, where appropriate.

We have considered how best to effect this requirement without making our charging rules unwieldy or including terms unnecessarily. Our proposal is to set out the common

terms in a separate document<sup>7</sup> with rule 12 (as we propose to amend it) incorporating use of the common terms in companies' Charging Arrangements into the scope of the rules. Ofwat will publish this document alongside the rules, and we consider it should be straightforward to amend or update from time to time, as the market develops.

We set out the proposed terms and the proposed requirement to use the terms in the draft rules published alongside this document.

## 2.2.5 Worked examples in new connections charging arrangements

### What we said in our June consultation

We provide guidance on how to set worked examples in the form of information requirements, which we publish in our annual charges information note. Using the information note has given companies scope to refine their approach to using worked examples. We welcome the efforts by companies and Water UK to improve consistency in the use of worked examples. We now propose to formalise the requirement to use worked examples in the English New Connection Rules from April 2022.

### Respondents' views

All respondents that commented on this proposal were in favour of having a requirement to include worked examples in companies' charging arrangements. However, several stakeholders had concerns that the proposed worked examples did not provide enough detail or the range of examples was too narrow.

- Water UK commented that the working group had agreed a standard format for presenting worked examples ("price tables") and suggested these price tables should also be included in our English New Connection Rules along with the scenarios.
- Several companies noted that they already provide worked example in their charging arrangements, although Yorkshire Water notes that these are likely to be inconsistent in scale and structure.
- Severn Trent, Barratt Homes, HBF and Vistry Group suggested the need for the inclusion of one or more worked examples that considered larger developments, for example those with between 500 and 5000 plots.
- Barratt Homes, FWC, HBF, Vistry Group and WA Consultancy considered that the proposed worked examples could benefit from having additional details, more

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<sup>7</sup> [Common Terms and Worked Examples – English New Connection Rules](#).

examples provided or additional clarification over certain terms. Severn Trent added that a requirement to use diagrams would help. On the other hand, Wessex Water cautions that being too prescriptive may be unhelpful, if local conditions mean slightly different specifications are more commonly experienced.

## Our view

We welcome the collaboration shown by companies in designing and agreeing to use the price tables, as well as agreeing what additional information should be included in the scenarios. A standard format for presenting worked examples should make it easier for other parties to understand and compare English companies' charges. We accept that some companies already use worked examples in their charging documents, and that customers may be familiar with them. We encourage those companies to engage with their stakeholders when they transition to the standard examples, to promote customer understanding and avoid confusion.

The worked examples we propose to include in the charging rules are meant as a minimum requirement and not a comprehensive list of all the examples that English companies should be providing. We do not intend to amend the scenarios proposed by the working group at this stage, although if it becomes clear that examples for much larger developments are required, we can review whether to include a new scenario in the standard information requirements.

We acknowledge Wessex Water's point about local conditions and accept that there will be instances where the examples do not cover every aspect of a particular development. However, they are also designed to demonstrate how a water company's charging arrangements work in practice rather than attempting to cover all eventualities. They are not designed to replace actual quotations for specific developments. Nevertheless, companies should consider whether there are benefits to providing additional worked examples of different scenarios where this can assist customers in understanding how their charging arrangements operate.

We have considered how best to implement the new information requirements. Our initial proposal was to include the scenarios in an appendix to the English New Connection Rules. This has the benefit of retaining all material pertaining to the setting and presentation of connection charges in a single document. However, with the addition of price tables in the appendix, we feel the English New Connection Rules may be becoming unwieldy. Therefore, our proposal is to set out the detail of the scenarios

and price tables in a separate document<sup>8</sup> with rule 11 (as we propose to amend it) incorporating use of the agreed scenarios and format in companies' Charging Arrangements into the scope of the rules. Ofwat will publish this document alongside the rules, and we consider it should be straightforward to amend or update from time to time, as the market develops.

We have also considered whether other requirements on companies in relation to the English New Connection Rules, currently in the [Information Note 20/07](#), are best kept there or should be transferred to the charging rules for greater clarity. Specifically, the existing requirement to explain significant changes in charges for new connections and new developments is closely related to the use of worked examples.

We introduced the information requirement to support bill stability and predictability for new connection services in [October 2019](#). It required water companies to publish statements of significant changes in charges for new connection services when publishing their charging arrangements for 2020–21. We initially set worked examples for companies to report whether bills for typical developments have increased by more than 10% and what handling strategies they have developed to manage the impacts of such increases. Following the introduction of this information requirement, companies started using those standard scenarios for typical development bills in the worked examples of the charging arrangements, with some additional or alternative scenarios to better reflect the needs of their customers.

With the requirement to use worked examples formalised in the English New Connection Rules, it seems sensible to formalise the requirement to explain significant changes in the English New Connection Rules too. Both requirements support bill stability and predictability.

We set out the existing requirement to explain significant changes in proposed new rules A2 and A3 in the [draft English New Connection Rules](#) published alongside this document.

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<sup>8</sup> [Common Terms and Worked Examples – English New Connection Rules](#).

## 2.2.6 Where to issue rules on infrastructure charges

### What we said in our June consultation

We propose to amend the document which sets out the rest of the Charges Scheme Rules (to remove the relevant rules on infrastructure charges) and the document which sets out the English New Connection Rules (to include the relevant rules on infrastructure charges), and provide additional explanation and signposting to be clear which rules are issued under which powers of the Act.

### Respondents' views

Respondents were in favour of the proposed change to the structure of the charging rules to move the charging rules on infrastructure charges into the English New Connection Rules.

- All of the companies that responded to the consultation confirmed that they supported the proposed change or had no objection. Only Welsh Water did not comment on this proposal.
- Barratt Homes, Vistry Group and HBF did not object to the proposal, but asked for clarity on why the change was being made.
- FWC agreed with the proposed change and also suggested making a similar amendment to the charging rules that relate to building water – the supply of water to development sites that is used during the construction process.

### Our view

We explained in our June consultation that the rules for infrastructure charges for English companies would fit more sensibly in the English New Connection Rules, along with other rules relating to the provision of new connection services. This change will make our charging rules more intuitive to use. This will not result change the rules governing the setting of infrastructure charges.

We are not persuaded of the benefits of making a similar change to the rules that govern the setting of charges for building water. The majority of the Wholesale Charging Rules apply to these charges, meaning there would be unnecessary duplication of these rules if we were to do so. However, we would encourage the companies to consider including in their developer services charging arrangements signposting on where to find information about charging for building water.

Given the strong support for our proposal, we will make the proposed change to the Charges Scheme Rules and the English New Connection Rules.

## 2.2.7 Income offsets and existing mains

### What we said in our June consultation

In the Charges Scheme Rules, the definition of income offset refers to premises connected to new mains. However, new premises may also be connected to existing mains. In these instances, the Charges Scheme Rules do not provide for companies to apply an income offset. Not all companies do provide income offset (we do not require it), but we consider it sensible to amend the definition to enable companies to apply it when new connections are made to existing mains if they choose to do so.

### Respondents' views

Overall, there was clear support for this proposal from the companies. All of the companies that commented on this proposal either supported the change or had no objections to the proposal. Several other stakeholders provided comments relating to the income offset, but these were not specific to this proposal. No stakeholder provided a clear objection to this proposal.

- Portsmouth Water, Severn Trent and United Utilities confirmed that they already provide income offsets when new connections are made to existing mains.
- Yorkshire Water and Northumbrian Water supported the proposal, but noted that as they did not offer an income offset, it would not affect their charges.
- FWC did not object to the proposal, but had concerns that it could lead to companies changing their charges, affecting ongoing developments.
- Barratt Homes, HBF, TDS, Vistry Group and WA Consultancy provided comments on the income offset that were not directly related to the change we are proposing.

### Our view

As there was clear support for our proposal, we will proceed with our proposed amendment to our charging rules. While there is a potential for this change to affect some companies' charges, we note that several companies confirmed that they either did not offer an income offset or they already provided an income offset where new connections were made to existing mains. As a result, we do not anticipate this proposal having a significant impact on charges.

## 2.2.8 Network reinforcement and NAVs

### What we said in our June consultation

As we grant more and more NAV applications, it is important that the relevant effects imposed on the neighbouring incumbents' networks are properly accounted for. We propose to amend the definition of "network reinforcement" to include costs incurred by the incumbent when bulk service NAVs cause them.

### Respondents' views

Overall, there was clear support for this proposal from the companies. Several other stakeholders raised concerns about the possibility that this proposal could harm competition with NAVs.

- Bristol Water only agreed with the proposal on the basis that it only included the network reinforcement costs incurred by the relevant water company and not costs incurred by the NAV or any other undertaker.
- Thames Water requested clarification or removal of the reference to "additional capacity in any earlier Water Main or Sewer" in the definition of Network Reinforcement. Thames Water said it was unclear how a retrospective requirement can be accommodated in a forward-looking calculation.
- Yorkshire Water agreed with the proposal, but also suggested that boundary meters should be included in the definition of costs that are considered to be network reinforcement.
- Barratt Homes, HBF, TDS, Vistry Group and WA Consultancy were all concerned about a potential for this change to disadvantage NAVs by increasing the costs they incur for network reinforcement.

### Our view

We do not consider that the proposal will disadvantage NAVs. As explained in the consultation document, the proposal would allow the companies to include in their calculations of their infrastructure charges information about the expected cost they will incur in providing network reinforcement as a result of new connections made both in their own area of operation and those made in relevant NAVs' areas (and to calculate the unit charge, they would divide the costs by the expected number of new connections in their area and in the NAVs' areas). This allows the companies to more accurately set their infrastructure charges to reflect the expected costs they will incur in providing network reinforcement. This is not an additional charge to NAV customers.

We can confirm that this change would only require the companies to include the network reinforcement costs they incur in the calculation of their infrastructure charges, not costs incurred by NAVs or other companies.

We set out the proposed change in the draft rules published alongside this document.

Thames Water's question about the reference to "earlier additional capacity" highlights an important part of companies' approach to infrastructure investment, specifically whether to invest in additional capacity above what might be immediately needed. It can be more efficient and cost-effective for a company to install additional capacity to that required by a specific development, if it thinks future developments in the area are likely to use the additional capacity. 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.

The definition of network reinforcement allows the costs of this additional capacity to be recovered through infrastructure charges. We are not convinced that the removal of this part of the definition would be in customers or companies' best interests. However, Thames Water queries the relationship between this cost and the application of the five-year rule to setting infrastructure charges. We consider this point in chapter three.

Yorkshire Water's request to include boundary meters for NAV sites served by incumbents touches upon other policy areas. We do not propose a change to our charging rules at this time to address this point but will keep that option under review.

## 2.2.9 Quotes for new connections spanning different charging years

### What we said in our June consultation

Currently there is no requirement on companies to explain the basis on which they provide quotes, although companies are required to set predictable charges and present them in a clear and accessible manner. We think it would promote clarity if we created a new rule that required companies to set out in their Charging Arrangements the approach they take to providing quotes.

### Respondents' views

There was strong support for this proposal and several companies noted that they were already providing this information.

- Severn Trent, Barratt Homes, HBF and Vistry Group commented on the need for there to be consistency in the approach taken by companies in setting quotations that span charging years.
- WA consultancy, TDS, Barratt Homes, HBF and Vistry Group commented that they want to be able to pay upfront for developments that span multiple years using the current year's charges. FWC also asked for the ability to fix infrastructure charges for the length of a development scheme rather than being tied to the year in which the connections are actually made.

## **Our view**

We appreciate that some stakeholders consider there to be benefits to having a consistent approach across the sector to setting quotations. However, we consider that this is an issue that is best decided between the companies and their customers rather than imposing an approach across the sector.

We are not persuaded by the requests to amend the charging rules to allow infrastructure charges for all properties on a development to be fixed at the current year's level charges, even though the development would take years to complete. To do so would not be properly cost-reflective; it appears to discriminate between single-year and multi-year developments where properties are connected in the same year but attract different levels of charge; and there would likely be additional unnecessary burden on companies to calculate infrastructure charges.

Given the strong support for our proposal to require companies to explain their approach to providing quotes, we will add this rule to the English New Connections Rules to increase the transparency and predictability of charges.

## 3. Setting Infrastructure Charges – clarification

### 3.1 Summary

Most of the 24 respondents to our consultation commented on the clarification we gave for the application of our five-year rule for setting infrastructure charges. We have [published responses on our website](#).

While there was much support for the way we raised awareness of the issue, there was a mixed response to the details we provided. Some respondents supported our approach and noting it is what they do already; others commented that they will review their approach in line with our clarification; and some expressed concerns, with different levels of severity.

- Affinity Water, Anglian Water, Bristol Water and Thames Water queried the interaction between the five-year rule and the guidance for Annual Performance Reporting (**APR**). They suggested table 2K implies companies should take historical imbalances into account when calculating infrastructure charges. Southern Water adds that the five-year rule refers to costs that the undertaker "reasonably incurs" which implies consideration of actual costs, not just forecasts.
- Thames Water said it was not clear how the reference in the definition of Network Reinforcement to "additional capacity in any earlier Water Main or Sewer", which it said is a retrospective requirement, can be accommodated in a forward-looking calculation.
- Affinity Water, Severn Trent, South Staffs Water and Thames Water said that delays in the timing of developments or other forecasting errors need correcting and the most straightforward way to do this is by including historical imbalances in the calculation of infrastructure charges. Otherwise, if the charges calculation did not include some regard to historical imbalances in costs and revenue, there is a risk that developers could be charged incorrectly. Wessex Water said that excluding recovery of imbalances can undermine stability and predictability. Severn Trent and Yorkshire Water said there is no regulatory mechanism to recover imbalances from developers, so they need to use infrastructure charges to do so.
- Bristol Water, Portsmouth Water, Severn Trent, Southern Water, South Staffs Water, Sutton and East Surrey Water, Wessex Water and Yorkshire Water comment on the difficulties caused by recovery of developer services revenue through the wholesale price controls along with revenue from other customers (the so-called 'single till'). They note the Developer Services Revenue Adjustment mechanism only corrects for differences in the number of properties connected and applies to general customers not developers.

- Severn Trent and United Utilities comment that five years is too short a time period for recovery of expenditure on network reinforcement. United Utilities adds that network reinforcement expenditure should include operating expenditure as well as capital expenditure.
- Barratt Homes, FWC, HBF, Vistry Group and WA Consultancy made general comments about underinvestment in infrastructure; about how developers' contributions are spent (including on water efficiency and sustainable drainage measures); the need for greater transparency (on an annual basis); and the apportionment between network reinforcement and other cost drivers.

## 3.2 Next steps

We encourage developers and other stakeholders to monitor companies' revenue from infrastructure charges relative to network reinforcement costs. Companies (excluding NAVs) publish this information in their APRs, for example in tables 2E, 2K and 2J. These are available on companies' websites. Using the APRs allows stakeholders to scrutinise companies, and this transparency builds trust and confidence that companies balance revenues from infrastructure charges with costs, as far as is reasonably possible.

In our June consultation we did not propose a change to the five-year rule, but to raise awareness of the rule's wording and to seek to avoid outcomes that would be detrimental to developer customers. We are encouraged that companies are also alert to this issue and thinking carefully as to how they can retain bill stability while setting charges that reflect expenditure. We are aware that many developers value stability in charges. Companies and other stakeholders will also be aware of our work looking into the regulation of developer services as part of our wider approach to PR24.

Several companies have asked for further clarity on and discussion of aspects of the five-year charging rule, including the interaction with other charging principles (cost reflectivity, stability and predictability), the time horizon over which costs and revenues should be balanced, the interaction between our charging rule (including the definition of network reinforcement) and the APR guidance, and the single till approach to developer services costs and revenue.

We agree there is need for greater consideration of the issues raised, notably the balance between the desire for developers to have stable predictable charges and to have charges that reflect cost, and the interaction with annual reporting and with PR24. We will consider how best to do this and revert to companies and stakeholders in due course.

## 4. Next steps

### 4.1 Issuing revised rules

This statutory consultation is the formal, final step before we issue revised rules, to take effect from **1 April 2022**, which we issue under the Act. The closing date for this consultation is 1 September 2021 and we will consider all responses carefully.

In accordance with the Act, we must not issue the revised Rules within 28 days after the consultation finishes (beginning with the day after the end of the consultation period) during which time the relevant Minister (the Secretary of State for the Environment in respect of English companies and the Welsh Ministers in respect of Welsh companies) may direct us not to issue the rules.

### 4.2 Wider work on developer services

This consultation fits into a wider programme of work on charges for and the regulation of developer services.

As we explained in our April 2021 consultation on [the scope and balance of developer charges and incentives](#), our aims are: (1) charges that reflect costs, supporting fairness and affordability across companies' different sets of customers; (2) charges that are transparent, benefit customers and, by supporting markets, offer developers greater choice; and (3) companies incentivising developers and third party providers to help meet long-term challenges, particularly through developing water efficient new homes and sites with sustainable drainage.

On the first of these aims, as we explained in our November 2020 conclusions, we have been undertaking further analysis of companies' costs and charges for new connections. As part of this, we have published a report, [prepared by SIA Partners](#), on variations in companies' charges for new connection services. We expect companies to use the information published in this report in setting their new connection charges for 2022 and beyond, using the principle of cost-reflectivity, along with the other principles in our charging rules including those of stability and predictability.

In addition, we have recently consulted on improving the consistency of [overhead cost reporting](#), including for developer services, which we consider to be relevant to the setting of charges.

Companies are addressing the second of these aims, notably through the use of refined worked examples and consistent terminology, as set out in this consultation.

In our April 2021 consultation, we received widespread support for the third of these aims, to incentivise the meeting of long-term challenges. We encourage companies to reflect on how they might use incentives, supported by clear communication and engagement, to support water efficient new homes and sustainable drainage in their preparation of charges for 2022-23.

We will conclude on our April 2021 consultation this autumn.

We are developing our thinking on the regulation of developer services, as part of our wider work on PR24. In May 2021 we [published work by CEPA](#) alongside our PR24 discussion document that identified two options – an adaptation of our current regulatory approach, or a more fundamental change in how we regulate developer services. We have [recently consulted on proposals to collect additional data](#) to support our consideration of the options identified by CEPA. We are considering our next steps in relation to these issues, in connection with our work on PR24.

**Ofwat (The Water Services Regulation Authority)  
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