

January 2022

Consultation under section 12A of the Water Industry Act 1991 on proposed modification to condition C of English water companies' licences

Ofwat

About this document

This document invites comments on our proposal to modify condition C of each English water company's Instrument of Appointment (**licence**).

In the context of this document, this means companies appointed as water and/or sewerage undertakers whose areas of appointment are wholly or mainly in England. For these purposes, we exclude those companies (new appointees), that are not subject to full price controls. Such companies do not have condition C, due to the additional regulation of the charges imposed by these companies at condition B of their licences.

The companies whose licences we propose to modify are:

Anglian Water Services Limited	Severn Trent Water Limited	Sutton and East Surrey Water plc
Affinity Water Limited	South East Water Limited	Thames Water Limited
Bristol Water plc	South Staffordshire Water plc	United Utilities Water Limited
Northumbrian Water Limited	Southern Water Limited	Wessex Water Services Limited
Portsmouth Water Limited	South West Water Limited	Yorkshire Water Services Limited

This consultation does not apply to the licences of companies whose areas are wholly or mainly in Wales as the legislative changes amending the charging regime have not yet been brought in by the Welsh Government, and for the time being condition C still applies in its entirety to those companies.

Condition C relates to infrastructure charges and was intended to apply to agreements made prior to April 2018. As currently worded, the condition might apply in certain other circumstances. This was not the intention of the condition, and our proposed modification would correct for that.

Under section 12A of the Water Industry Act 1991 (**WIA91**), we are able to modify the conditions of an English water company's licence subject to the procedural requirements set out in sections 12A-12I WIA91. Our pre-consultation engagement indicates that all of the English water companies are in principle in favour of this proposal.

Before making modifications under section 12A of the WIA91, Ofwat must give notice in accordance with that section. In respect of the licences of each English water company, this document is a Notice under section 12A of the WIA91.

Responding to this consultation

We invite the English water companies and other stakeholders to comment on our proposed modification by **11 March 2022**. Please email your responses to Charging@ofwat.gov.uk.

Subject to our consideration of any representations received in response to this consultation, we propose that the modifications to each English company's licence should have effect from **1 April 2022**.

We have decided to reduce the period between deciding to make the modification, following the consultation, and the modification taking effect from the standard 56 days period to a 14 day period. We have done this in order to complete the licence modification process in time to provide the water companies with certainty over this licence condition before the beginning of the 2022-23 charging year. We set out more details on this decision in section 3.

We intend to publish responses to this consultation on our website at www.ofwat.gov.uk. Subject to the following, by providing a response to this consultation you are deemed to consent to its publication. If you think that any of the information in your response should not be disclosed (for example, because you consider it to be commercially sensitive), an automatic or generalised confidentiality disclaimer will not, of itself, be regarded as sufficient. You should identify specific information and explain in each case why it should not be disclosed and provide a redacted version of your response, which we will consider when deciding what information to publish. At a minimum, we would expect to publish the name of all organisations that provide a written response, even where there are legitimate reasons why the contents of those written responses remain confidential.

In relation to personal data, you have the right to object to our publication of the personal information that you disclose to us in submitting your response (for example, your name or contact details). If you do not want us to publish specific personal information that would enable you to be identified, our [Privacy Policy](#) explains the basis on which you can object to its processing and provides further information on how we process personal data.

In addition to our ability to disclose information pursuant to the WIA91, information provided in response to this consultation, including personal data, may be published or

disclosed in accordance with legislation on access to information – primarily the Freedom of Information Act 2000 (FoIA), the Environmental Information Regulations 2004 (EIR) and applicable data protection laws.

Please be aware that, under the FoIA and the EIR, there are statutory Codes of Practice which deal, among other things, with obligations of confidence. If we receive a request for disclosure of information which you have asked us not to disclose, we will take full account of your explanation, but we cannot give an assurance that we can maintain confidentiality in all circumstances.

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1. Background and reasons

1.1 Licence condition C – Infrastructure charges

Each water company's licence includes a series of conditions setting out obligations the company has in relation to its regulated activities as an appointed water company. licence condition C relates to setting infrastructure charges.

The purpose of the infrastructure charges provision was to protect customers by setting a limit on the amount of infrastructure charges that water and wastewater companies could collect from them. Infrastructure charges can be levied whenever a customer connects a household property to the public water or wastewater system for the first time, as set out in section 146 of the WIA91.

On 1 April 2018, a new charging regime for developer services was introduced for English water companies wholly or mainly in England. Changes to the WIA91 introduced by the Water Act 2014 ([WA14](#)) removed much of the statutory framework prescribing the fixing of specific charges previously set out in the WIA91 and provided Ofwat with the power to set charging rules. As part of this change to the charging regime, we modified the licences of the English water companies wholly or mainly in England to remove licence condition C, save for insofar as the transitional provisions discussed below retained it, as the regulation of infrastructure charges was now included in our charging rules. The relevant sections were initially set out in our Charges Scheme Rules,¹ and from October 2021 appear in the New Connections Charging Rules.²

New developments can take several years to fully build out. As a result, when the new charging regime came into effect there would have been some developer services which had already been agreed and/or partially charged for under the old charging regime, but for which some charges had yet to be levied. To ensure that these agreements were not disrupted by the introduction of the new charging regime, the Secretary of State included transitional provisions within the legislation which allow such agreements made before 1 April 2018 to be charged for under the old charging arrangements. This transition period only applies to agreements to provide developer services made before 1 April 2018 ([Legacy Agreements](#)).

¹ [Charges scheme rules - Ofwat](#)

² <https://www.ofwat.gov.uk/regulated-companies/company-obligations/charging-rules-from-april-2022/>

As part of this process we also included a transition process in licence condition C allowing infrastructure charges, which were not covered by the legislative transitional provision, in such circumstances to continue to be capped by the limit in condition C as well. Our intention was to ensure that customers would be charged an appropriate infrastructure charge, reflecting the different approaches taken to charging for off-site reinforcement works under the old charging arrangements and under our new charging rules.³

Our intention was to remove condition C entirely at a later date once the Legacy Agreements had been completed and the condition was no longer needed.

1.2 The problem we are seeking to address

The aim of the transitional process provided by condition C was to allow the new charging regime to come into effect without disrupting Legacy Agreements that had been made between a water company and its customers to provide new connection services. However, the wording of the transitional process in paragraph 16.2 of condition C may result in it applying to the provision of new connections in circumstances that were not intended. Specifically, the limit set out in condition C continues to apply whenever any infrastructure charge is imposed in relation to a new connection made to a water main or sewer that was charged for under the old charging regime, even if it was not a connection provided for or connected with an agreement reached in the transitional period.⁴ This was not the intention of the transitional process.

1.3 Potential scale of this issue

Ahead of proposing this modification, we contacted the English water companies to gather information about the potential scale of any unintended consequences if we did not modify condition C. Based on 2021–22 charges, six English water companies have either a water or wastewater infrastructure charge that exceeds the maximum that would be imposed by the current wording of condition C. We expect this number to be similar for the 2022–23 charging year.

³ See further on page 25 of our 2017 consultation on these charging rules, [New Connections Charges for the Future - England](#)

⁴ In other words, a new development in respect of which network reinforcement costs would not have been factored into the earlier charges already paid at the time of the main or sewer being provided.

Although this issue only affects fewer than half of English companies, we propose to change the licences of all the English water companies because:

- Some companies' infrastructure charges may rise above the limit set by condition C in future years;
- Condition C was only intended to protect customers for infrastructure charges made in connection with Legacy Agreements. The intention was to remove this condition when it was no longer needed; and
- We consider it to be beneficial for each water company to have the same licence conditions wherever possible. This helps to reduce any potential unintended consequences that can arise from having different licence conditions between water companies and makes any future changes to water company licences simpler.

Under our Charging Rules for New Connection Services (English Undertakers),⁵ English Companies are required to set their infrastructure charges in accordance with the principle that the amount of such charges will over each period of five consecutive charging years cover the costs of network reinforcement that the relevant undertaker reasonably incurs. If a water company has customers which have Legacy Agreements and it has an infrastructure charge that exceeds the limit set by the current wording of condition C it would need to either:

- Set a higher infrastructure charge for customers making connections that are not affected by the limit imposed by condition C (customers making connections to water mains or sewers built after 1 April 2018) in order to collect an overall infrastructure charge revenue that matched the expected costs of network reinforcement works; or
- Recover from its other customers the revenue that was not recovered from infrastructure charges due to the imposition of the limit set by condition C.

Neither of these two results are desirable as in both cases, the charges for customers are less cost reflective due to the impact of condition C being applied where it was not intended.

On the basis of these responses, we have concluded that the current wording of condition C has the potential to have a material and unintended impact on the infrastructure charges set by several water companies. The results of this unintended consequence would adversely impact the charges being set for customers and could

⁵ [Charging Rules for New Connection Services \(English Undertakers\) – Effective from April 2022 – Ofwat](#).

lead to charges that are less fair and cost reflective. We are therefore proposing to modify the licences of the English water companies to avoid this issue.

1.4 Our proposed solution

We informally consulted with the English water companies in October 2021 on a draft change to the wording of condition C that could be applied. The majority of water companies did not raise any concerns with the proposed wording. However, some suggested alternative wording to the proposal. The suggestions were primarily concerned with ensuring that the transitional provision in condition C would only ever be applied to the intended new connections and that it would not affect charges for any other connections to old mains or sewers which were never intended to be charged under the old charging arrangements.

One company proposed an alternative approach to addressing this issue – to remove condition C entirely. It argued that condition C was not providing any additional customer protection above that which is provided by the existing charging rules and the incentives placed on water companies, such as the Developer Services Measure of Experience (D-MeX).⁶

We consider that this approach is, on balance, the most appropriate way to address the issue. We agree that it is not clear cut to re-draft the transitional provision in a way which ensures that only infrastructure charges connected with Legacy Agreements benefit from the cap, without creating undue complexity and administrative burden for companies.

The current charging rules for infrastructure charges⁷ require the English Companies to set their infrastructure charges under principles including fairness, predictability and transparency. Companies are also required to take reasonable steps to ensure that the balance between contributions to costs by developers and other customers prior to 1 April 2018 is broadly maintained. This means that in practice the charging rules already require the English Companies to set different infrastructure charges for customers that had developer services that are being charged for under the pre-April 2018 charging arrangements. We note that the charging rules, which have included the provisions in relation to infrastructure charges since December 2016, are now a well-

⁶ [Customer and developer services experience - Ofwat](#)

⁷ These rules are currently in the Charges Scheme Rules, but will be moved into the Charging Rules for New Connection Services (English Undertakers) from 1 April 2022.

established framework. We therefore consider that there would not be a regulatory gap relating to the protection of those customers paying infrastructure charges in connection with Legacy Agreements.

Our charging rules are clear that as long as the difference between amounts is cost-reflective, a water company may set different infrastructure charges to reflect different circumstances.⁸ As a result, the removal of the limit on infrastructure charges provided by condition C would not require the English companies to charge customers with legacy agreements the same infrastructure charges as customers that requested a developer service after 2018. We would expect companies to clearly explain these charges in their published charging arrangements, in accordance with the requirements that companies clearly set out how infrastructure charges have been calculated set out in our Charging Rules for New Connection Services (English Undertakers).

Finally, the transitional provision in condition C was only intended to apply to agreements to provide developer services that were made before 1 April 2018. This means the number of developments to which the transition process should be applied will reduce each year as these Legacy Agreements are completed and charged for. We always intended to remove condition C when it became redundant. By removing condition C now, we can also remove the administrative burden on both ourselves and the water companies of making multiple changes to this licence condition, as well as resolving the problem of the cap applying to unintended types of connections.

Overall, we conclude that the transition process in condition C does not appear to offer any additional customer protection to that provided by the existing charging rules. Removing this licence condition would also remove any possibility of the limits imposed by this licence condition being applied to new connections to which it was not intended.

⁸ See Rule 56 in the Charging Rules for New Connections Services (English Undertakers).

2. What is the change that we are proposing?

Our proposal is to remove condition C from the licences of the English Companies with effect from 1 April 2022.

Condition C relates to infrastructure charges and was intended to apply to agreements made prior to April 2018. As currently worded, the condition might apply in certain other circumstances which were not intended to be within scope of the condition. Removing the condition addresses this. The rationale for retaining condition C was to provide protection for legacy agreements, but the charging rules provide this protection.

The new appointees that operate wholly or mainly in England do not have a licence condition C, as a result, we do not need to modify their licences.

3. Our decision to reduce the statutory consultation period

When we consult on a proposal to modify the licence of a water company under section 12A of the WIA91, we are required to consult for a period of 42 days. During that period, the Secretary of State (in the case of English companies' licences) may direct us not to make the modification.

Following that consultation, having considered any representations (and unless the Secretary of State has directed us not to), we may decide to modify the licence and we must give notice of that decision, stating the date at which the modification will have effect. That date must usually be not less than 56 days from the date of the decision and during that period the companies whose licences are affected (as well as any person whose functions include representing these companies, or the Consumer Council for Water) may appeal against our decision to make the modification to the Competition and Markets Authority ([CMA](#)).

However, section 12B provides Ofwat with the power to reduce the period between the decision and the taking effect of the modification where we consider it necessary or expedient for the modification to have effect more quickly, and where we have in our original consultation stated the date from which the proposed modification should have effect, set out our reasons for proposing the earlier effective date and explained why it is our view that this earlier effective date would not have a material adverse effect on any person holding an appointment as an undertaker or a licensee.

Based on the water company infrastructure charges for 2021-22 and early information provided by the water companies about their 2022-23 charges, we anticipate that at least six water companies will have infrastructure charges for 2022-23 which will be higher than the limit that would be set by the transitional process in condition C. We are therefore looking to make this licence modification before 1 April 2022 in order to provide the certainty that these companies will need to set their charges in the 2022-23 charging year. If we provided the full 56 day consultation period, the modification of the water company licences would not be completed until 6 May 2022, potentially impacting the ability of the water companies to set their charges for the 2022-23 charging year.

In order to allow the licence modification to be completed before the 2022-23 charging year begins, we have decided to reduce the length of the consultation period to 14 days in accordance with section 12B of the WIA91.

It is our view that this earlier effective date will not have a material adverse effect on any person holding an appointment as an undertaker or a licensee. Before issuing this consultation document, we contacted the regulatory directors of the English water companies to provide early drafts of the proposed licence modification and to allow them to raise any concerns with the proposal. None of the water companies indicated that they did not agree with the proposal to modify condition C to address the issue identified.

We also note that the following:

- The need for the proposed licence modification was raised by one of the water companies;
- The proposal would remove a restriction that would otherwise be imposed on the setting of charges by the water companies;
- The proposal is being made to address an issue with the wording of condition C that resulted in a wider effect than was intended, as set out in the consultation document that introduced the transitional process into condition C;⁹ and
- The removal of the cap in condition C will be revenue-neutral for the companies.

As a result, we do not expect that the proposed licence modification will result in any material adverse effect on any of the companies, or any other person. Therefore, we conclude that it is expedient to reduce the length of the consultation period under section 12B of the WIA91 in order to complete the modification of the water company licences ahead of the time by which the English water companies will issue charges in the 2022-23 charging year.

Finally, we are aware that the CMA has not yet published its guidance setting out how it will process appeals against a decision to modify a water company's licences. However, this would not prevent any water companies from making such an appeal as they would still have the right to do so even before the guidance has been issued. We also have the option of not going ahead with this modification if objections to this proposal are raised. Additionally, based on our correspondence with the water companies so far, we have not seen any indications that any of the companies have any concerns over this proposed modification.

⁹ [New connection charges for the future - England - 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

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