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1 August 2023

Dear Ofwat,

Re: Consultation on Environmental incentives to support sustainable new homes

I am writing to you on behalf of Independent Water Networks Limited ("IWNL"), part of the BUUK Infrastructure Group of companies, in response to your consultation on Environmental incentives to support sustainable new homes, published 20 June 2023. This letter presents a summary of our views on the proposals set out in the consultation; we respond in turn to the questions that you raised in Appendix 1. I can confirm that this response is not confidential and can be published on the Ofwat website.

The context surrounding water efficiency and sustainable drainage

At IWNL we are fully invested in the move toward improving the sustainability of homes in the UK. We acknowledge the challenges the water industry is facing associated with increasing water scarcity as a result of a growing population and rising environmental constraints. As referenced in the 2022-23 IWNL Customer Statement, we actively promote water efficiency to our customers; with an aim of reducing per capita consumption (PCC) below the new Government standard of 125 l/p/d for new homes. However, we recognise that customers typically do not actively consider their water consumption; an observation that was highlighted by recent Water UK research which concluded that the "vast majority of Brits have no idea how much water they use each day". To this end, we led a recent Independent Networks Association (INA) submission to Ofwat's Discover Water Challenge, where we proposed the development of a 'Multi-utility app' that would provide end-customers with visibility over their water, gas and electricity use. The expectation was that this would drive behaviour change by effectively communicating the value of consuming less water.

The challenges of water scarcity should not however overshadow the significant difficulties that the industry is facing due to the increasing incidence of floodwater and the challenges that this poses for the existing sewer network. Recognising this, we have been instrumental in working alongside other NAVs and developers to pioneer the installation of sustainable drainage systems (SuDS) in England; an approach which is now being implemented nationwide under Schedule 3 of the Flood and Water Management Act 2010. We therefore see the advantages of standardising the design of SuDS components given the benefits it could have in terms of expediting the sign off of SuDS plans for new developments; which would allay one of our most significant concerns regarding the implementation of Schedule

3. This would also ensure that lessons learned were effectively implemented, from the experience of developers following the adoption of Schedule 3 regulations in Wales.

Summary of IWNL views on the Ofwat consultation

We welcome the focus that Ofwat has given to water efficiency and sustainable drainage via the publication of this consultation as, in line with our comments above, we are fully invested in moves toward improving the sustainability of homes in the UK. We also welcome the collaborative, industry-led approach Ofwat has taken to the development of these proposals. However, we have concerns that this consultation does not reflect any new or renewed thinking on the issues; rather, the proposals largely replicate the tiered approach that has already been developed by incumbents in the market e.g. Thames and Southern Water. In this respect, we think the consultation represents a missed opportunity to take a meaningful step forward in the development of innovative environmental incentives. We also have concerns with the construct of the incentives themselves, for the following reasons.

- **Bronze – Development built to at least 100l/p/d:** As outlined above, we are committed to supporting water efficiency and to reducing PCC below the new Government standard of 125 l/p/d for new homes. However, the development of a 'blanket' standard for water efficiency incentives of 100 l/p/d is a substantial 'jump' in PCC as compared with the current average PCC level of 145 l/p/d reported on the Discover Water website. A jump of this magnitude would require significant investment in water efficiency fixtures and fittings by the developer; suggesting that any incentive would need to go some way toward offsetting this. It also underestimates the behavioural change required on the part of end customer in terms of effectively reducing their water consumption; and embedding this change over the longer term. We think it is important to recognise that, in the absence of provisions that effectively manage this change, customers with low-flow fittings and fixtures could simply complain to their supplier / the developer and / or swap the low-flow rate fittings for ordinary ones which would negate the incentive entirely. We note that avoiding these outcomes is particularly important from a NAV perspective given that incumbents inevitably reflect assumptions about lower PCC in the associated bulk supply agreements (BSAs) they agree with NAVs and therefore, if low-flow devices are removed, this introduces a constraint when NAVs breach the provisions of the BSA. However, incumbents do not all apply and / or enforce the same restrictions and conditions to new developments where the incumbent builds or adopts the new water connections. This has created an uneven competitive environment for NAVs and also brings into question the long-term effectiveness of the incentive. We propose that the same long-term requirements are applied to all new developments equally.

- **Silver – Rainwater harvesting / recycling or water reuse:** In principle, we support the inclusion of progressive incentives in these areas given the improvements in water efficiency they could facilitate. However, we note that challenges and difficulties have been faced with many of these types of schemes that have been progressed to date; including issues associated with possible cross-contamination and the potential insufficiency of supplies during dry summer months. In some cases, we are aware that customers have established bypass arrangements to effectively cut out the schemes. Recognising this, we suspect that developers will likely require a substantial incentive to accept such offerings; to offset not only the cost of the scheme but also the associated increase in risk. However, this still does not account for the increase in risk the adopting water company will face once the scheme is operational and water quality concerns become a reality. We are also aware that the DWI's Deputy Chief Inspector has expressed concerns directly to IWNL around the use of grey / rainwater recycling for the 'domestic purposes' listed in Section 218 of the Water Industry Act 1991, including 'drinking, washing, cooking, central heating and sanitary purposes'. They note that using grey / rainwater recycling schemes in this way, directly conflicts with British Standard BS16941 which specifies installation and water quality standards for 'non-potable systems' and emphasises the critical need to keep non-potable supplies separate and distinct from drinking water. Given the challenges faced with these kinds of schemes and concerns expressed by the DWI, we think a more credible incentive could be developed around communal rainwater harvesting using large tanks to provide effective water storage for recreational (as opposed to domestic) purposes.

- **Gold – Water neutrality:** We are also supportive of the principle of moving toward water neutrality via a service that incorporates water efficiency visits and retrofitting of water saving devices to other properties. However, without clarity on the specifics of the offering, such as the types of services that would be included, their respective costs and the associated level of the incentive, it is difficult for us to comment on the attractiveness of the potential product. If the incentive were to be structured in a similar way / level to those offered by Southern and Thames Water we do not think this would be sufficiently attractive for developers to engage in this service. In fact, we are not aware of any cases in which developers have agreed to engage in commercial water neutrality contracts, despite the Thames Water offering being available in the market for nearly 16 months. While we agree that water neutrality offers much promise, it hasn't yet been proven in the real world and the fact that these types of initiatives are still being awarded funding under the Ofwat innovation competition highlights just how 'new' and risky they are.

Suggested alternative solutions that could be explored

We recognise that the challenges posed by water efficiency and sustainable drainage are significant and that these are not easy issues to resolve. We are aware, however, that substantial, extensive discussions have taken place on these issues and this has highlighted a number of possible solutions that we think may merit further exploration.

- **Rising bloc tariffs:** Adopting an approach such as this would expose customers to higher water costs where they exceed a certain consumption level and therefore place the onus onto them to adjust their water usage. This recognises the limited awareness that customers currently have with respect to their in-home water use. It would also seek to address the fact that a large proportion of water used in the home is wasted; a fact highlighted by the recent CCW report 'Lifting the Lid: the secrets of our water habits', which found that over six in ten (63%) feel they could be more water efficient, with many admitting to running the shower for longer than is necessary. At present, customers are not exposed to the costs of this wastage due to the low volumetric cost of water and this approach would significantly change that dynamic. In addition, we are aware that, for the 2023-24 charging year, Affinity Water announced that they would be trialling a rising bloc tariff comprising 1,500 participants and we anticipate that the results of this trial should provide insights with respect to the viability of such a scheme.

- **Other innovative tariff approaches:** During discussions at the Ofwat-led bulk supply working group (BSWG) four sub-groups were established and one of these specifically related to environmental incentives. The outcome of this sub-group was a paper, written primarily by Affinity Water, which presented a worked example for the way that tariffs could be structured to encourage / incentivise greater use of greywater / rainwater harvesting and / or water reuse systems. Limited discussion of this paper took place at the working group itself, but we think there would be merit in further engagement on these types of tariff arrangements.

- **Communal rainwater harvesting:** As outlined in the preceding section, we think a more credible incentive could be developed around communal rainwater harvesting using large tanks to provide effective water storage. This could be particularly effective on new developments given that the water storage could be effectively transported to customer homes and used for recreational (as opposed to domestic) purposes, including car washing, watering lawns and communal spaces, and cleaning outdoor areas. This would ultimately remove any of the risks associated with cross-contamination and water quality concerns. If combined with rising bloc tariffs and / or other innovative tariff approaches, we think these could have a meaningful impact on water use.

- **Smart meters:** Accelerating the use of smart meters would not only increase customer visibility and overall awareness of their water use, but would also provide water suppliers with greater transparency regarding the real time water use of their customers. In this respect, it would allow for easier identification of in-home and / or supply pipe leaks that customers may not be aware of as well as allowing us to target water efficiency messages to end customers with higher overall levels of water consumption. We are also aware that developers are supportive of installing smart meters as these devices would allow them to market their homes as 'eco-friendly' without the complications associated with explaining more complex product offerings such as greywater recycling.

We recognise that, given the clarity Ofwat recently provided to industry around its position on charging trials in its Consultation on charging innovation to support affordability, all of these possible approaches could be explored independently by industry parties but we think there would be value in Ofwat providing leadership on the viability of options such as these. We also believe Ofwat has a role to play in ensuring that any new incentives do not unduly constrain growth or skew the competitive environment.

I hope that this letter is helpful. If you have any questions on any of the issues I have raised or would like to discuss these in more detail, please feel free to contact me.

Kind regards,

[redacted]

[redacted]

Group Regulation Director

Appendix 1: Responses to specific questions posed in the consultation

Q.1 Do you agree with our proposed aim for environmental incentives?

We agree with the overall aim that environmental incentives should result in greater water efficiency and / or more sustainable drainage across all types of new development. Given government ambitions around the growth of the housing market, and recognising that new housing provides a 'blank slate' for the application of innovative approaches, we think that new developments are a good place to start. This could also provide insights in terms of the application of possible solutions / techniques / approaches to the wider housing stock which comprises a far greater proportion of overall customer consumption.

Q.2 Do you have any comments on the characteristics of good environmental incentives?

We are supportive of the overall characteristics of good environmental incentives that you have presented in the consultation.

- **Transparent, stable and fair:** We very much agree that there should be alignment between the principles adopted for environmental incentives and those established with respect to charging. Transparency in this respect should be provided to all affected parties, including end customers, developers, NAVs and Ofwat (as applicable). The need for fairness is particularly pertinent in the case of environmental incentives recognising that, at present, many of the offerings allow for payments to developers to install low-flow devices but do not equally recognise the resulting constraint that NAVs subsequently face. In this respect, incumbents seek to reflect corresponding lower PCC assumptions in associated BSAs agreed with NAVs and therefore, if low-flow devices are removed, this introduces a risk that NAVs could breach the provisions of the BSA. It is important that established provisions do not unduly penalise NAVs for actions outside of their control. Further, incumbents do not all apply and / or enforce the same restrictions and conditions to new developments where the incumbent builds or adopts the new water connections. This has created an uneven competitive environment for NAVs and also brings into question the long-term effectiveness of the incentive. We propose that the same long-term requirements are applied to all new developments equally.

- **Support innovation:** This is a fundamental prerequisite for any evolving / emerging area of market conditions. We think that the clarity that Ofwat recently provided to industry stakeholders with respect to its position on trials, in its Consultation on charging innovation to support affordability, will help to support this principle.

- **Accessible to all:** We strongly support this principle and believe that any incentive offered direct to developers via incumbents should also be available to developers where they decide to contract with a NAV for a new site. This will avoid creating any unintended distortions within the competitive market.

- **Complement wider policy:** We understand the criticality of this principle and recognise that the strategy behind these incentives is aligned to government targets on PCC.

- **Build trust & confidence:** We support this principle and anticipate that it is most likely to be achieved where principles of transparency, stability and fairness are also met.

Q.3 Do you have any comments on the extent to which any environmental incentives could or should be adapted for implementation in Wales?

As far as it is possible, within the bounds of current legislation, we think that equivalent environmental incentive provisions should be implemented in Wales. Not only would this ensure that developers and end customers have equivalent access to any environmental incentives that emerge in the market (both over the short and longer term) but it will also help to maximise the potential delivery of water efficiency benefits in Wales. This is particularly pertinent recognising the findings of the Water Research centre (WRc) study that were presented in the consultation. In this example, WRc assessed the effectiveness of building regulations related to PCC / specified flow rates in terms of impacting domestic consumption in Wales across a sample of 80 properties in the Welsh Water operational area; and found that 'no single property complied with the regulations'.

Q.4 Do you have any comments on the case studies outlined?

As outlined above in our cover letter, while we welcome the innovative approaches that Southern and Thames Water have sought to take to environmental incentives, we have residual concerns with elements of each of the respective offerings.

- **Tier 1:** We are very much supportive of the intent of encouraging greater end customer water efficiency via the installation of low-flow fittings and fixtures in new homes on new development sites. However, we are aware that many customers will have expectations about the perceived quality of the fixtures and fittings in their new homes and the speed at which they deliver water e.g. showers and taps. If they are unsatisfied with these, they could simply complain to their supplier / developer and / or swap the low-flow rate fittings for standard ones which would negate the incentive entirely. If these outcomes are observed, and customers choose to remove the low-flow fixtures and fittings, this creates a significant risk for NAVs. In this respect, incumbents will inevitably reflect assumptions about lower PCC in the associated bulk supply agreements (BSAs) they agree with NAVs and therefore, if low-flow devices are removed, this introduces a constraint if NAVs breach the provisions of the BSA. However, incumbents do not all apply and / or enforce the same restrictions and conditions to new developments where the incumbent builds or adopts the new water connections. This has created an uneven competitive environment for NAVs and brings into question the long-term effectiveness of the incentive. We propose that the same requirements are applied to all new developments equally.

  We note that this concern is supported by the findings of the United Utilities case study presented in the Ofwat consultation. In this example, United Utilities offered an efficiency incentive to developers where they committed to achieving consumption levels of 100 l/p/d, with successful applicants subject to an audit on fixtures and fittings. However, of 156 properties audited between January 2021 and June 2023 only 37% passed; and this serves as a direct illustration of the concerns we have around Tier 1 of the Southern and

Thames Water schemes. This concern translates to other similar schemes being offered by incumbents across the industry.

- **Tier 2:** We are supportive of the inclusion of progressive incentives around greywater recycling given the impacts it could have in terms of water efficiency. However, we note the challenges and difficulties that have been faced with the majority of greywater recycling schemes progressed to date; including issues associated with possible cross-contamination and the potential insufficiency of supplies during the dry summer months. In some cases, we are aware of customers that have established bypass arrangements to effectively cut out the greywater recycling scheme; arrangements which clearly do not comply with applicable water regulations. We are sceptical that many developers will take up this type of incentive given the relatively immature status and knowledge of these technologies as well as the relatively higher risk of failure of such schemes. We are also aware that the DWI's Deputy Chief Inspector has expressed concerns directly to IWNL with respect to the use of grey / rainwater recycling for 'domestic purposes' in line with those listed in Section 218 of the Water Industry Act 1991 which covers 'drinking, washing, cooking, central heating and sanitary purposes'. They note that use of grey / rainwater recycling schemes in this way, is in direct conflict with British Standard BS16941 which specifies installation and water quality standards for 'non-potable systems' and emphasises the critical need to keep non-potable supplies separate and distinct from drinking water.

- **Tier 3:** We appreciate the possibility to facilitate water neutrality through the provision of a service that incorporates water efficiency visits and retrofitting of water saving devices to other properties. However, while we recognise the potential value of these measures, it is unclear to us where the incentive would be for developers to engage in this service, particularly recognising that a relatively substantial contribution from the developer is still required. We can see that, from an incumbent's point of view, water neutrality would reduce PCC and leakage (leading to potential incentive payments under their ODIs) but there doesn't appear to be an equivalent incentive for developers. While we agree that water neutrality offers much promise, it hasn't yet been proven in the real world and the fact that these types of initiatives are still being awarded funding under the Ofwat innovation competition highlights just how 'new' and risky they are. In fact, we are not aware of any cases in which developers have agreed to engage in commercial water neutrality contracts, with Thames or Southern Water as the available incentive is insufficient to offset the associated cost and risk.

Q.5 Do you have any comments on our proposed standardised incentive tiers?

We welcome the focus that Ofwat has given to water efficiency and sustainable drainage via the publication of this consultation as, in line with our comments above, we are fully invested in moves toward improving the sustainability of homes in the UK. We also welcome the collaborative, industry-led approach Ofwat has taken to the development of these proposals. However, we have concerns that this consultation does not reflect any new or renewed thinking on the issues; rather, the proposals largely replicate the tiered approach that has already been developed by incumbents in the market e.g. Thames and Southern Water. In this respect, we think the consultation represents a missed opportunity to take a meaningful step forward in the development of innovative environmental incentives. We also have concerns with the construct of the incentives themselves, for the following reasons.

- **Bronze – Development built to at least 100l/p/d:** As outlined above, we are committed to supporting water efficiency and to reducing PCC below the new Government standard of 125 l/p/d for new homes. However, the development of a 'blanket' standard for water efficiency incentives of 100 l/p/d is a substantial 'jump' in PCC as compared with the current average PCC level of 145 l/p/d reported on the Discover Water website. A jump of this magnitude would require significant investment in water efficiency fixtures and fittings by the developer; suggesting that any incentive would need to go some way toward offsetting this. It also underestimates the behavioural change required on the part of end customers in terms of effectively reducing their water consumption; and embedding this change over the longer term. We think it is important to recognise that, in the absence of provisions that effectively manage this change, customers with low-flow fittings and fixtures could simply complain to their supplier / the developer and / or swap the low-flow rate fittings for ordinary ones which would negate the incentive entirely. We note that avoiding these outcomes is particularly important from a NAV perspective given that, as outlined above in our response to question 4, if low-flow devices are removed, this introduces a constraint if NAVs breach the provisions of the BSA. However, incumbents do not all apply and or enforce the same restrictions and conditions to new developments where the incumbent builds or adopts the new water connections. This has created an uneven competitive environment for NAVs and also brings into question the long-term effectiveness of the incentive. We propose that the same long-term requirements are applied to all new developments equally.

- **Silver – Rainwater harvesting / recycling or water reuse:** As set out in our response to question 4, in principle we support the inclusion of progressive incentives in these areas given the improvements in water efficiency they could facilitate but it is important to be cognisant of the challenges and difficulties faced with these types of schemes. Within this context, we suspect developers will likely require a substantial incentive to accept such offerings; to offset both the cost of the scheme and the increase in risk. However, this still does not account for the increase in risk the adopting water company will face once the scheme is operational and water quality concerns become a reality. We are also aware that the DWI's Deputy Chief Inspector has expressed concerns directly to IWNL with respect to the use of grey / rainwater recycling for 'domestic purposes' given that, in line with BS16941, there is a critical need to keep non-potable supplies separate and distinct from drinking water. We present further details regarding the DWIs concerns in response to question 4 above.

- **Gold – Water neutrality:** As outlined above in our response to question 4, we are supportive of the principle of moving toward water neutrality but, without clarity on the specifics of the offering, it is difficult for us to comment on the attractiveness of the potential product. If the incentive were to be structured in a similar way, and at similar levels, to those offered by Southern and Thames Water we do not think this would be sufficiently attractive for developers to engage in this service.

Q.6 Do you have any comments on our proposal for a common methodology / technical standard to assess water efficiency?

Recognising the issues highlighted above with respect to the ongoing effectiveness of the schemes in delivering the water efficiency benefits they are purported to provide, we think it may be prudent for a national body to provide oversight for this scheme. The role of the national body would be to complete spot audits to confirm that (a) developers have installed the devices they committed to provide (b) these devices remain in situ and (c) the expected levels of water efficiency are being delivered. The challenge for such a scheme would be to ensure, learning lessons from the implementation of schedule 3 in Wales, that the body could provide required assurance around the water efficiency credentials of a project while also ensuring developments are not unduly held up.

We note that the costs of setting up a completely new body to perform this role are likely to be substantive and would therefore suggest that an existing independent organisation could be used for this purpose, such as Waterwise or the Energy Savings Trust. This would facilitate transparency around whether the efficiency benefits anticipated when incentives were agreed with the developer were, in effect, delivered for a defined period of time once end customers took up occupancy in the premises.

Q.7 Do you have any comments on the details of our proposal for companies to offer bespoke incentives?

In line with the principle of supporting innovation set out above in question 2 with respect to the characteristics of good environmental incentives, we think it is important that companies are permitted to offer bespoke incentives under the scheme. Recognising that the significant challenges posed by water efficiency and sustainable drainage are not easy to resolve, we are fully supportive of any initiative that encourages the industry to continually consider solutions that could facilitate improved environmental outcomes.

Despite substantial, extensive discussions on these issues, an ideal solution that effectively aligns behaviours between incumbents, developers, NAVs and end customers has yet to be identified and / or implemented; and allowing bespoke incentives to emerge will avoid any unnecessary barriers to this outcome. In effect, we see this element of the provisions as a complement to the clarity that Ofwat recently provided to industry regarding its position on charging trials, in its Consultation on charging innovation to support affordability.

Q.8 Do you have any comments on the potential for reputational incentives?

We see that reputational incentives could be a particularly important tool to utilise in emotive areas such as the environment given that water companies and developers alike will be keen to accrue kudos, with customers and regulators, where they perform comparatively well as compared with industry counterparts. In this respect, if they qualify for an industry 'kitemark' that demonstrates their proactivity in working towards the industry's environmental goals, this is an achievement that they are likely to want to promote given the greater emphasis that is increasingly being placed on sustainability goals. However, we would warn against leaning too heavily upon these types of regulatory tools given the costs associated with facilitating environmental improvements and the need for proportional financial incentives that go some way toward compensating companies for their efforts in this area.

Q.9 We seek views on how the process for agreeing and paying environmental incentives might best be organised in practice, and whether this is consistent with existing developer services processes.

We agree that for the scheme to be a success, it will be important that developers have trust and confidence that they will receive payment for the costs they incur in the installation of low-flow fixtures and fittings, greywater recycling or water neutrality assets in new build homes. In addition, any NAVs involved in the development will need to have trust and confidence that (a) the relevant assets have been installed in new homes in line with commitments made by developers (b) these devices remain in situ and (c) the assets are delivering the outcomes anticipated at the outset. We think that any NAV concerns in this regard could be addressed by effective governance arrangements, as discussed above in our response to question 6.

We are supportive of proposals to make use of existing developer service initiatives to further facilitate trust and confidence on the part of developers with respect to the receipt of incentive payments. In this respect, industry could work together to establish an appropriate metric around environmental incentive payments that could sit alongside the existing suite of Water UK metrics that inform Ofwat's performance assessment under the D-MeX. This process could be carried out in parallel with a more general rationalisation of the existing suite of D-MeX incentives to ensure that the ones retained for PR24 reflect those that are most critical from the perspective of all industry parties. In addition to the quantitative metrics, targeted questions could also be included as part of the qualitative survey to provide a more holistic understanding of incumbent company performance.

Q.10 Do you have any comments on how high levels of compliance with the incentive technical standards might best be achieved?

In line with the concerns that we expressed in response to question 4 above, we are very much attuned to the importance of ensuring technical compliance with the environmental incentives that are offered, to assure that developers are meeting the requirements of the relevant schemes and the expected levels of water efficiency are therefore achieved. This is of particular importance from our perspective given the potential implications for our associated BSA arrangements if either (a) developers do not deliver on their commitments or (b) the anticipated levels of water efficiency are not observed.

As set out in our response to question 6 above, we think it may be prudent for a national body to provide oversight for this scheme. The role of the national body would be to complete spot audits to confirm that (a) developers have installed the devices they committed to provide (b) that these devices remain in situ, and (c) the expected levels of water efficiency are being delivered. As also noted above, we expect that the costs of setting up a completely new body to perform this role would likely be substantive and we would therefore suggest that an existing independent organisation could be used for this purpose.

In line with this, we are supportive of proposals to make any payment conditional on a sample of new homes passing an audit of compliance once the fittings have been installed. We are also supportive of proposals that allow for developers to be disqualified from applying for certain future environmental incentives, for a defined period, following a failure on a compliance audit.

Q.11 Do you have views on whether environmental incentives are best funded as an environmental component of the infrastructure charge or as a separate charge?

We agree with the overarching principle that environmental incentives should be self-funded and that it should not be possible for incumbent water companies to benefit financially from overcharging. We also support proposals to incorporate the environmental incentives as an additional component of the infrastructure charge as this would follow a similar approach to the payment of income offset; the prohibition of which effectively triggered the development of environmental incentive arrangements. This would also help to facilitate simplicity in the administrative arrangements implemented to support the provisions. We note that, in the consultation, Ofwat also specifies that it would not expect companies to use the revenue for any other purpose. We very much welcome this clarification and consider that, if any concerns around the use of funds are raised in the future, this should be subject to a full investigation by Ofwat or any oversight body that may be appointed (in line with the comments that we made in questions 6 and 10 above).

Q.12 Do you have any comments on our proposal for guidance issued under the charging rules and how they are developed and maintained?

We are supportive of the proposals to issue guidance under the charging rules given the clarification that this will provide in terms of Ofwat's expectations regarding environmental incentives and the consistency that this should help to facilitate. We note the related proposal to develop this guidance via the Water UK new connections committee (NCC). While we consider that this may be an appropriate forum in which to develop the provisions, it is important to be aware that developers do not typically attend this group and that most of the NAV community are also not members of Water UK in their own right, which means they may not have a full opportunity to engage. Recognising both this, and the fact that progress in the BSWG has been somewhat limited in recent months, we think there is a rationale for using this group to develop the guidance. We also think there is a clear rationale for Ofwat to undertake a formal consultation inviting interested stakeholder views on the contents of the proposed guidance prior to implementation. We would welcome Ofwat's views on this.

Q.13 Do you have any comments on our approach for managing interactions with the regulatory framework?

We agree with the proposal that incumbent water companies should issue details of their environmental incentives as part of the process of annually publishing their full suite of tariffs and that this should include an explanation of how developers can qualify for these incentives. We think there should be an expectation that developers will proactively promote these incentives to their developer customers and, in line with our commitment to supporting water efficiency and reducing PCC, we will also proactively promote these offers.

We were encouraged to see Ofwat's active consideration of how NAVs and SLPs might be impacted by the arrangements and the potential implications that they could have for the ongoing maintenance of a level playing field. In particular, we welcome the thought that Ofwat has given to the need for the common framework to establish a basis and approach for NAVs to be compensated, for example, for investment and ongoing maintenance of development-level water recycling arrangements. In addition to this, we think it is important that the framework also recognises the increased risks that such arrangements would create for the ongoing effective operation of our network assets and the continued provision of a reliable service to our customers. It is for these reasons, that we suggested above, that a more credible incentive could be developed around communal rainwater harvesting using large tanks to provide effective water storage, given the reduced risks to water quality and associated levels of water resilience / security that this would create.

We note Ofwat's statement that 'new appointees have the opportunity to innovate and differentiate their offerings by designing more ambitious incentives, which could be desirable from a developer's point of view.' While we acknowledge that these opportunities exist, we note that the ongoing discussions that have taken place via the BSWG, where NAVs have consistently sought to highlight to Ofwat and incumbent companies that we do not think the current margins available to us, via the bulk supply tariffs, fully reflect the value that we provide to the industry. Linked to this, the current margins available place restrictions on us in terms of our ability to proactively offer environmental incentives to developers. If, as we have discussed at length during the BSWG meetings, material improvements in the levels of transparency surrounding the composition of bulk supply tariffs were implemented, it would allow us to identify areas where our contribution is being undervalued and on which we could challenge incumbents regarding their tariffs. If the margins were, in turn, to become more reflective of the value we provide to the industry, we could consider ways to share some of this improvement in returns with our customer base, possibly via environmental incentives.

The consultation also highlights the perverse incentives that currently operate on NAVs with respect to water use. In this respect, where developers choose to accept an offer of an environmental incentive from a water company, this will ultimately decrease the volume of water used by customers and the NAV will as a result receive less financial renumeration than they would have otherwise. This is the rationale underpinning our suggestion, outlined above in the covering letter of this response, that there would be benefit in considering the implementation of alternative tariff arrangements, such as rising bloc tariffs and / or the other alternative tariff arrangements that were initially proposed by Affinity Water at the BSWG. We would welcome the opportunity to discuss these types of approaches with you, either during a one-to-one meeting or during future meetings of the industry BSWG.