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27<sup>th</sup> October 2023

Dear Ofwat,

**Re: Anglian Water response to: Changing Ofwat's charging rules to support the new developer services framework, August 2023**

I am writing in response to the 'Changing Ofwat's charging rules to support the new developer services framework' consultation, August 2023. This letter, along with the supporting annex, provides our response.

We remain supportive of the decision to de-regulate site-specific developer services as part of PR24 and are keen to ensure a clear and simple transition into the next AMP.

We are generally supportive of the proposals laid out in this consultation document, in particular the proposals for tethering, principles relating to overheads and changes to the infrastructure charge calculation, and think there is merit in the proposals for unbundling. We feel these support progress towards transparency and cost reflectivity. However, we have some reservations and concerns that we feel need to be addressed and have provided detail on those reservations within the responses to the questions in the supporting annex.

Apart from the specific comments detailed in the annex, we are broadly supportive of this and other, related consultations that have been published this summer, including those relating to D-Mex and Environmental incentives. We believe collaboration is important with both Ofwat and our Developer Services customers including Self Lay Providers (SLPs) and New Appointments and Variations (NAV), and remain proactive in finding new and innovative ways of working to deliver better customer service and find suitable efficiencies where possible.

Please contact me if you have any questions relating to anything contained in this consultation response.

Yours sincerely



**Darren Rice**

Regulation Director

# Anglian Water response to: Changing Ofwat's charging rules to support the new developer services framework, August 2023

## Responses to Questions

- 1) What are your views on our proposal to link charges for different types of development through the use of tether ratios? What are your thoughts on the use of ratios based on industry maximum figures, not average or median figures?

We are overall supportive of the suggestion of Option 4, Tethering, and welcome a move away from the suggested 'capped' charges for those customers with limited market choice. We agree that capping charges or restricting charging increases in-line with CPIH, as laid out in Options 1 & 2, could cause charges to become non-cost reflective. In addition, we don't feel that capping net margin, as suggested in Option 3, would provide any protection for customers for their charges or promote efficiency.

There is a danger, that over time, the charges within the non-contested scenarios could become less and less reflective of the costs exactly because they are tethered to charges in somewhat different scenarios; but (i) this danger is mitigated by using industry maximum figures and (ii) as discussed in the consultation, it seems to be the least worst way of protecting customers in these scenarios – there doesn't seem to be a better way.

De-regulation and the separation of Developer Services activity outside of the price control from 1<sup>st</sup> April 2025, as well as the movement toward greater unbundling as laid out in Option 5, is a significant change and therefore may have a material impact on costs and charges in the next price regulation period. Companies are still adjusting and re-balancing charges linked with prior charging regimes and rule setting. We therefore suggest that the baseline for setting a tether ratio should be re-assessed based on 2025-26 (Year 1 of AMP8) charges.

We agree that the tether principle would be simple to implement and monitor, however setting the right tether is a material undertaking and it's important to get the detail right.

We do not agree that infrastructure charges should be included in calculating tether ratios:

- Infrastructure charges are non-contestable and should be equivalent across customer types and market segments. Setting tether ratios and then applying them to charges that include infrastructure charges could impede cost recovery for network reinforcement.
- Including infrastructure charges in a common tether ratio is a blunt instrument given infrastructure charges vary significantly between companies due to available network headroom, pace and location of growth. Include infrastructure charges in setting ratios could offer a windfall for companies with low infrastructure charges and a headwind for those with higher infrastructure charges in balancing cost and revenue.
- Infrastructure charges could change significantly over time, particularly between now and during AMP8. As such a fixed tether ratio for the AMP appears inappropriate when infrastructure charges will need to evolve and adapt depending on scale and location of growth in company areas.

We have concerns about setting a single tether ratio for the AMP for the industry. We believe that these should potentially be set on a company specific basis and need to be reviewed from time to time to ensure they are not distorting the market.

2) What are your views on option 5 that companies should individually charge for separate activities involved in making service connections? Do you agree with our proposal to implement via changes to the wording of the CTWE?

We are supportive of the continued move towards the principle of unbundling, as detailed in Option 5, of Developer Services charges and are already making steps towards this principle in current charging arrangement reviews for 2024-25 charging year as well as ensuring that each component is cost-reflective. For example, we want to ensure that customers have the ability to select the relevant charge for their requested activities; such as 'lay only' examples that are already highlighted through the worked examples.

We agree that, such as the 'lay only' example above, this allows a developer to reasonably pay for the element of work they are receiving. In this example, the development site likely includes new mains in association with the new connections, and it is also likely that the developer is undertaking activities in the near vicinity of the new mains pipework. They therefore may reasonably dig their own trench while working in that vicinity and also have the ability to provide their own reinstatement after the new pipework is laid. The developer therefore, should only reasonably pay for the pipework laid by others, rather than a 'bundled' charge that includes both trench digging and reinstatement.

We agree that unbundling offers greater transparency of charges and further scrutiny of them by interested stakeholders. However, we remain cautious that splitting our charges may result in unnecessary divergence in delivering the specified service connection.

We do not expect that unbundling should result in inefficiency for companies or lead open up risks previously mitigated. An unintended consequence of unbundling is that customers may have the ability to 'pick and mix' from the listed activities, leading to a cross-over in delivery between statutory undertakers and third parties such as SLPs or telecoms providers (for example). This has further complications in overall accountability for the service connection and similarly may distort D-Mex levels of service or customer satisfaction. We don't agree that unbundling should entitle a customer to choose only those service items from a 'list' of unbundled items, relevant to that service connection, that would otherwise leave the project inefficient and uneconomical. There are a number of further risks associated with this;

- Health & Safety – multiple parties operating in close proximity, that are not adequately coordinated, can lead to additional risks and potential H&S issues. In addition, uncoordinated activities, procured as a consequence of cost, may lead to instances of delayed or dormant open/live works, which in itself is a H&S issue to both the developer and potential members of the public.
- Design liability – Work carried out by multiple parties may result in additional complications to insurances and design liability. Additionally, the ability for a single connection example, for example one carried out by a homeowner or occupier, may result in the customer unknowingly project managing their new connection and taking on principle designer/contractor duties, dependent upon the service items they have procured.
- Risks to project timescales – for example, where traffic management may be procured by one party, but the groundworks and connection procured by another, there may be a risk that timescales do not align and permits may not be sufficient for the intended works. Delayed, or extended project durations, may also lead to a rise in public complaint due to extended road closures, and possible C-Mex implications.
- Lack of project accountability for end to end delivery; including a risk to D-Mex where customer is not clear on satisfaction via a number of delivery providers. There is also a risk that incomplete

connections could be made; i.e. without a meter or 'yellow plug'. This could lead to potential water quality risks or delays to account creation and revenue collection.

- Inefficient work practices that are uneconomical and not attractive to commercial delivery partners

We agree that setting the unbundling principle can be implemented through changes to the Common Terms & Worked Examples (CTWE) and agree with the proposed deletion of the current wording.

- 3) Do you have views on our proposals to add two new worked examples with the aim of providing additional protection for developments with limited choice? What are your views on suitable new scenarios?

We agree that worked examples provide a useful benchmark for comparing the cost of carrying out certain types of connections and adding two further scenarios, as detailed in Option 6, targeted at those customers with limited market choice, helps display a broader range of service connection types.

We feel however, that through the addition of Option 5, unbundling, that customers should be able to self-calculate their charges, specific to their development site, regardless of displaying further scenarios for differing property numbers.

In addition, we feel that published examples are only an indicative view of simple new connection projects and do not take into account any variables that are specific to different development sites, dependent upon their nature.

We provide an interactive water connection calculator tool on our website<sup>1</sup> which enables customers to calculate their indicative cost for their development, currently up to 10 plots, using rates taken from our published charging arrangements<sup>2</sup>. We are very keen to evolve this tool to further reflect principles affecting future charges, as well as broadening its use for larger development sites with larger number of properties. We feel that this tool, alongside current scenarios and the addition of unbundling, provides greater transparency and ability for a customer to pre-calculate their indicative new connection costs without unnecessary administration burden to create unlimited scenarios.

- 4) Do you agree with our proposed general guidance for RAG2 regarding a fair allocation of all relevant overheads across ALL expenditure areas, including developer services?

We interpret this question to be in relation to central (corporate) overheads. In relation to those overheads, we agree with the principle that overheads should be allocated in a fair and consistent manner. We already allocate central overheads to developer services activities as we recognise these costs are incurred as a part of delivering all our capital programmes.

- 5) Should RAG2 specify methods of overhead recovery for developer services? Are there any disadvantages to doing so? Are there any methods that you think would be appropriate to use across the industry that would drive consistency?

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<sup>1</sup> Anglian Water Connection Calculator - <https://www.anglianwater.co.uk/developing/water-services/five-steps/water-connection-calculator/>

<sup>2</sup> Anglian Water Charging Arrangements - <https://www.anglianwater.co.uk/siteassets/developers/new-content/charges/aws-charging-arrangements-202324-sm.pdf>

We have reservations about the potential for providing a prescribed methodology for allocating overheads. The flat rate mentioned in paragraph three on page 27 of the consultation document could lead to more or less overhead being allocated to a given scheme than would ordinarily be due. This would be at odds with the principle of cost reflectivity and ensuring there is no cross subsidy between activities inside and within the Price Control.

Companies should be required to recover an appropriate amount of overhead from developer services activities, which is consistent with the principle of no cross subsidy, but be left to determine the most appropriate method on a case by case basis.

6) Do you agree that RAG2 could be extended to cover the recovery and allocation of overhead costs between developments with and without a mains requirements? Do you have any suggestions as to how this should be done?

We are committed to the principle of allocating direct costs to the appropriate service as would be expected of any reasonable undertaker. Overhead costs, by their nature, are more difficult to easily identify the most appropriate cost driver and we therefore believe it should be up to each undertaker to make this assessment on a case by case basis.

We happen to already operate with three local overheads (connections, water mains and sewerage) as we believe this gives us a clear line of sight between our back office work and the assets we are constructing. However, we feel it should be at the discretion of each undertaker to most appropriately determine their overhead structure, rather than it being stipulated in RAG2.

7) What are your views on our proposal to carry out a market review prior to PR29?

We are supportive of a market review prior to PR29 as this will provide a good overview to the success of de-regulation of site-specific developer services activities and also provide a greater insight into the drivers and behaviours surrounding competition within the sector.

We are supportive of competition within the sector and feel that we have a good level of competitor activity in our region with both Self-Lay Providers (SLPs) and New Appointments & Variations (NAVs). We recognise these customer types and are supportive of their activity and service delivery to the customers living and working in our region. We regularly engage with these customer types and invite feedback on their views to improve and expand on our service offerings, as we do all our customer types.

We believe that the review could focus on the benefits of competition in our area, to both customers and incumbents and it would be useful to explore greater analytics of the variations of competitive activity across the UK, understanding the drivers for this.

In addition, we feel that in order to get a realistic picture of how the sector is performing, given the new changes to regulation and charging rules, it would be beneficial to undertake this analysis a few years into the next AMP. This would allow companies time to adjust and settle their processes as they respond to these changes in a de-regulated market.

8) What are your views on our proposal that companies include historical variances between expenditure and revenues in setting infrastructure charges?

We are supportive of the proposal that would allow companies to include historical variances between expenditure and revenue in setting infrastructure charges. We feel that this principle is in-line with cost reflectivity principles and allows companies to respond to unexpected fluctuations in growth forecasts.

In addition, this also allows companies to align a greater portfolio of growth network reinforcement schemes with wider infrastructure projects, gaining efficiency through combining scheme delivery, as the risk of overspend against revenue can be corrected in subsequent years, whilst maintaining a broad view on total infrastructure reinforcement works for growth across the AMP and beyond.

We do however feel that this proposal should only apply moving forward rather than be implemented retrospectively. There have been numerous changes to regulation and charging rules over the last few AMPs, with varying principles and charging schemes. We feel that it would be simpler to incorporate and track if this applied from Year 1 of AMP8. For example; in Year 1 of AMP8, we use our forecast to set our infrastructure charges; in Year 2 of AMP8, we account for any over/under recovery of revenue from year 1 against the forecast to set our infrastructure charges; and so on.

We feel that this proposal would also complement the potential changes proposed in question 9, as managing growth across catchments is a very live and dynamic arena which can often change based on developer build rates, planning delays and other external impacts; for example, the current economic impact the industry is experiencing. We collaborate regularly with our developer customers and gain regular insight through detailed engagement on growth and development in our region. Through this, and the combination of relieved pressure on revenue recovery through the mechanism of accounting for historical growth, we can respond to this insight in a more agile, tactical and innovative way.

#### 9) Do you agree with our proposal to enable companies to take account of upsized infrastructure when setting infrastructure charges?

We are fully supportive of the proposal to enable companies to take account of upsized infrastructure when setting infrastructure charges and acknowledge that setting infrastructure charges has been problematic and cumbersome to implement since the end of Relevant Deficit (RDs) and Discount Aggregate Deficit (DADs) calculations from previous AMPs.

We feel that companies should be allowed to take account of upsized infrastructure when setting infrastructure charges as this is fundamental to ensuring a dynamic and flexible approach to investment that supports growth both in the short and long term. We feel that this principle, in combination with historical variance accounting, would support more efficient solutions, including: reducing costs associated in duplicating assets, reduced environmental impacts and carbon footprint, as well as generally creating the right solution in the adoption and management of assets for many years to come. Upsizing of network reinforcement also supports catchment wide solution planning as well as greater collaboration with developer customers, SLPs & NAVs when designing and investing.

Finally, we feel that encouraging initial upsizing leads to greater stability in the network, and consequently less risk on network opportunity; resulting in lower demand for responsive maintenance and ultimately ensuring that bill paying customers are not adversely offsetting previous developer growth activity.

#### 10) What are your views on our proposals relating to how we accommodate changes to the provision of income offset?

We agree with the proposals relating to the changes to the provision of income offset and agree that companies should have the ability to honour the income offset discount to completed developer agreements, that have referenced the inclusion of income offset for properties connected in association with that requisition.

We have acknowledged Ofwat's intentions to remove the ability for companies to offer income offset from 1<sup>st</sup> April 2025, and have since reflected this change within the wording of our agreements and terms letters. We will continue to honour the income offset for those customers with an completed (signed) 'old' terms letter for the remainder of their properties directly linked to this agreement. We do not intend to offer income offset to any properties or developments that have signed our 'new' agreements or terms letters, that are not connected and been notified to us by the 31<sup>st</sup> March 2025.

In addition, we plan to communicate this change and reflect this within our developer charging arrangements.

We do not intend to offer the income offset to any NAV properties that are not connected and notified to us by the 31<sup>st</sup> March 2025 as each of their property connections are not subject to a pre-existing agreement or requisition guaranteeing an income offset. Therefore, only properties connected and notified by 31<sup>st</sup> March 2025 will be eligible for an income offset discount.

Finally, we note reference to the 'environmental component' that has been amended as part of rule 53. We agree with the principle of environmental incentives and that these should be self-funded by the developer community. However, in addition to our response to the 2023 consultation on environmental incentives<sup>3</sup>, customers may be disincentivised by the lower tiers that do not offer sufficient value to invest in materials or technologies that help to deliver a level of water efficiency, compared to the 'environmental component' they are subsequently offsetting. We suggest, the 'surcharge' or 'environmental component' should only apply to customers who are not intending on constructing homes that will deliver to an agreed sustainable standard as laid out in the incentive scheme.

We are however, supportive of the working group, proposed by Ofwat, to prepare new guidance on environmental incentives to help with the transition to a common framework and keen to participate in this moving forward.

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<sup>3</sup> 2023 Ofwat Environmental Incentives Consultation - <https://www.ofwat.gov.uk/wp-content/uploads/2023/06/Consultation-on-Environmental-incentives-to-Support-Sustainable-New-Homes.pdf>