



Llywodraeth Cymru
Welsh Government

Charging Guidance to Ofwat Relating to Developer Charges, Bulk Supply Charges and Access Charges

2017

Mae'r ddogfen yma hefyd ar gael yn Gymraeg.
This document is also available in Welsh.

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1. Introduction

- 1.1. This charging guidance is issued under Section 144ZE of the Water Industry Act 1991 (“the Act”) as inserted by the Water Act 2014.
- 1.2. This guidance relates to three different areas of charges imposed by water and/or sewerage undertakers (“undertakers”): charges for new connections to water and sewerage networks (‘developer charges’); charges for bulk supply and bulk discharge; and charges for access to water undertaker networks.
- 1.3. The Act requires undertakers to comply with Ofwat’s rules in setting their charges. If Ofwat considers that an undertaker is not acting as required by the rules they can issue a direction to the undertaker. In producing charging rules, Ofwat must prepare a draft of any proposed rules and consult relevant persons before the rules come into effect. Ofwat’s charging rules will be subject to public consultation. The Welsh Ministers have powers to direct Ofwat not to issue the rules, for example, if they consider the rules are not consistent with its guidance. Where the Welsh Ministers issue revised guidance, the Act requires Ofwat to review and, if necessary, revise the relevant charging rules.

2. Context

- 2.1. Our guidance cannot extend to how Ofwat produces the its charging rules. Nevertheless, we ask Ofwat to make provision to review the rules on a regular basis, taking into account the extent and content of price review determinations made and the outcome of consultation. We also ask Ofwat to update the charging rules, when appropriate, to ensure they continue to provide a transparent, efficient, fair, reasonable and effective charging system that keeps pace with any future developments in the sector.
- 2.2. Ofwat must undertake a statutory consultation before it publishes its charging rules in accordance with procedures set out in the Act. We ask that Ofwat undertakes reasonable steps to make its consultation clear and easy to understand and set within the Welsh legislative and regulatory framework.

2.3. We consider an appropriate mechanism for reporting, monitoring and company assurance around undertakers charges for new connections will help to ensure transparency and clarity of charges, and build confidence in the charging rules system, as well as to reduce the incidence of disputes. Therefore, we encourage Ofwat to consider how it can put in place such a mechanism.

3. Guidance on charging rules for new connections charges

3.1. The Act provides for undertakers to charge for new connections to the network, and for associated work. These refer to charges levied by undertakers for new connections to water and sewerage networks and provision of any associated infrastructure. They may apply to developers, self-build and self-lay customers.

3.2. There are three key charges related to development connections:

- The connection charge to recover the cost of connecting a property to the existing main or sewer.
- The infrastructure charge to contribute towards the cost of extending the local water distribution network and local sewerage network. The charge is currently capped on a per property basis, as set out in licence condition C of undertakers' licences. Infrastructure charges are not intended to cover the cost of providing additional capacity at water or wastewater treatment works.
- The requisition charge to contribute towards the reasonable cost of providing the required water distribution and sewerage infrastructure for a particular development, outside the local network. The charge is currently calculated for individual developments where the costs of infrastructure provision are offset against calculated revenue. The developer makes a contribution where the cost of providing the infrastructure exceeds the calculated revenue from the development over a twelve year period.

In addition to the above there are a number of ancillary charges (e.g. design, administration fees that could be charged.

3.3. This guidance on charging arrangements for new connections applies to domestic use of water and sewerage services, either in a household or a non-household property. It relates to the following types of charging rules Ofwat can introduce under the Act:

- Self-lay and adoption of water infrastructure (section 51CD);
- Self-lay and adoption of sewerage infrastructure (section 105ZF);
- Water and sewerage connections and associated works (section 144ZA (1)(a) – (g)), including charges for moving pipes (section 185)

- 3.4. Ofwat's charging rules should require that undertakers' charging arrangements are set in accordance with the principles set out below and they should promote effective, timely and proportionate consultation. This should help ensure the charging schemes take into account local circumstances within each appointment area.
- 3.5. In designing these new charging rules Ofwat should, as far as reasonably practicable, ensure that the rules are compatible with each other and where this is not possible we would expect undertakers to have flexibility to deliver charging arrangements in line with customers and stakeholders views. We would expect Ofwat's rules to encourage companies to consult extensively and as soon as is practicable. Ofwat should encourage companies to engage with all relevant stakeholders, including Consumer Council for Water and developers and to publish a statement setting out the engagement undertaken, how they have taken the views of stakeholders into account, and set out and justify where there is a trade-off between the principles below and any competing priorities and objectives raised by stakeholders.

i) Simplicity and Transparency

Charges should be transparent, simple and comprehensible. This will reduce uncertainty in the assumptions water and sewerage undertakers and developers make in planning their business.

Ofwat should publish clear principles on the costs that different charges are designed to recover, as well as the calculation of asset payments and income offsets. Simplicity and transparency can be enhanced by:

- ensuring there is a clear boundary (i.e. no potential overlap) between the costs that different charges ought to cover;
- allowing companies flexibility to alter the way any income offset is calculated.

ii) Stability, Predictability & Timeliness

Developers should be able to plan the costs of development with confidence. Charging rules should encourage consistency in the approach to charging for connections or adoption of infrastructure. Information on the types of charges that can apply, and what these charges can consist of, should be made accessible to developers.

Developers attach great importance to stability in charging for costs, and in particular that charges quoted by undertakers before works begin are realistic, fair and accurate. Charging rules should, as far as possible, clarify who bears the risk in the event that the actual cost of works varies between estimates made by the undertakers and the charges ultimately imposed. Developers should not normally be required to pay charges that are higher than those

quoted unless they are as a result of inaccurate information provided by the developer, or of a failure by the developer to act in accordance with any terms of agreement with the undertaker. Where there is a need to adjust charges to make them more cost reflective undertakers should be open and transparent about the nature and scale of potential charges should be managed in such a way that is it clear and justifiable. Where developers do face additional charges these should be clearly justified.

iii) Fairness and cost reflectivity

Charges that are clearly reflective of the work involved will build confidence of developers and allow developers to plan and budget for new developments more effectively.

Developers should bear the on-site costs that reflect the cost of their connections to, or adoption of, water and sewerage systems. They should also bear the costs needed to provide and augment the existing network infrastructure (on or off the development site) such that the network can meet the need associated with their connections to, or adoption of water and sewerage systems.

Developers should not be required to bear the costs of reinforcing, upgrading or otherwise changing existing network infrastructure to address pre-existing shortfalls in capacity or capability or to provide future capacity. Where infrastructure is provided that has a greater capacity than needed for a specific new development, the rules should ensure costs are appropriately apportioned and allocated to the new development.

Ofwat should require undertakers to consider a range of options for their charging structure to ensure the selected charging structure is the most appropriate. We note the interest expressed by some customers / stakeholders in a simple, averaged cost charging structure that applies across an undertaker's area. We also recognise there might be a trade-off between such an approach and, notably, promoting the environmental sustainability objective, below. This approach would require careful consideration with respect to competition law given the nature of contestable and non-contestable services, but importantly the charging rules should not restrict innovative approaches undertakers (in line with customer/stakeholder support) may put forward that comply with competition law requirements.

The current balance between contributions to costs by developers and bill payers should be broadly maintained, although Ofwat may review and consult on this, and, if necessary recommend changes to this guidance in the future.

If requiring the infrastructure charge to be cost reflective leads to an increase in infrastructure charges, then the undertaker could increase its income offset so reducing the net requisition charge to retain the current balance of costs in aggregate. Undertakers should decide on the appropriate trade-off based on a number of factors, including the outcome of consultation, and provide a clear rationale for their decision.

iv) Environmental Sustainability

Charges should adequately reflect relevant costs in order to provide incentives for efficient resource use and innovative solutions that are sustainable over the longer term, where appropriate, taking into account interactions and incentives brought about by other parts of the regulatory landscape.

The costs of providing or reinforcing infrastructure can depend on the decisions made by the developer in respect to location of the site. Charges for connections should reflect the costs of the different decisions. This can act as a signal to developers to encourage more efficient use of resources.

The Sustainable Drainage Systems (SuDS) approach is central to future surface water management, and can be used to help comply with European, UK and Welsh environmental and water quality legislation. SuDS schemes can reduce the volume and flow of excess surface water entering the sewerage infrastructure. In line with their legal and regulatory duties, sewerage undertakers may adopt some types of SuDS features and infrastructure.

Undertakers do not have a duty to adopt SuDS unless they qualify as sewers, drains or sewage disposal works for the purposes of section 104 of the Act. but they do have a power to construct their own SuDS (section 114A).

Ofwat should consider how the charging rules can promote the use of SUDs. For example there may be scope to incentivise the use of SuDS by others where they are making connections to the public sewerage system, by providing for discounts or preferential rates in such circumstances.

v) Additionally, Ofwat should consider and consult on:

- Whether undertakers' charging arrangements could have different implications for single build applications and multiple builds and, if so, whether charging rules should apply differently in order to reflect these impacts;
- A rule to require non-contestable charges to broadly equal costs over a set period to help to ensure that these prices are kept to broadly cost reflective levels. There is much less scope for regulation to determine the approach to contestable charges.
- Whether transitional arrangements are necessary, and if so, what arrangements in order to minimise the burdens on all parties of the transition from existing requirements to new charging requirements, so developers and undertakers can manage their relationships and plan with confidence and clarity.

4. Guidance on charging rules for bulk supply and bulk discharge.

These principles apply to agreements between undertakers wholly or mainly in Wales, and, where consistent within the legal and regulatory framework should be applied to cross border agreements.

- 4.1. Bulk supply agreements are agreements between appointed water undertakers for the connection and transfer of water from one undertaker to the other. They can be a mechanism for improving network resilience, they can aid water undertakers in meeting their obligation to supply water services more efficiently, and they can be a means for new appointees to supply water to their customers.
- 4.2. Under section 40E of the Act Ofwat will have the power to make charging rules for bulk supply agreements. The Welsh Ministers have powers to issue guidance of Ofwat on the content of those charging rules under section 40I of the Act, and also under section 144ZE of the Act, they have powers to give guidance to Ofwat on the principles to be applied by Ofwat in determining these charging rules.
- 4.3. Bulk discharge agreements are agreements between sewerage undertakers to make a main connection into one of the undertakers' sewerage systems. These agreements are referred to as 'sewerage main connection agreements' in the Act and are analogous to a bulk supply agreement for water.
- 4.4. Under section 110F, Ofwat will have the power to make charging rules for sewerage main connection agreements and Welsh Ministers have powers to issue guidance to Ofwat under section 110J of the Act on the content of those charging rules. Under section 144ZE of the Act, Welsh Ministers also have powers to give guidance to Ofwat on the principles to be applied by Ofwat in determining these charging rules with regards to connection agreements involving connection into the sewerage system of a sewerage undertaker whose area is wholly or mainly in Wales for the benefit of another such undertaker. The power to issue guidance is exercisable jointly with the Secretary of State where the connection agreement relates to a connection into the sewerage system of a sewerage undertaker whose area is wholly or mainly in Wales for the benefit of a sewerage undertaker wholly or mainly in England, or vice versa.
- 4.5. In setting charging rules Ofwat should take an approach towards New Appointments and Variations (NAVs) and new market entrants which seeks to ensure a level playing field and not to regulate to actively encourage them at the expense of existing or future customers of either the NAVs or the appointed undertaker in order to promote competition within a neutral charging framework.

- 4.6. In setting charging rules Ofwat should consider the appropriate balance of incentives that charges reflect the full cost of the trade, including environmental costs and impacts on the resilience of water supplies where such costs would otherwise be incurred by Welsh customers. The Welsh Government expects Ofwat to ensure so far as it is consistent within the legal framework within which it operates and our arrangements with the UK Government that new cross-border bulk supplies are not subsidised by customers of undertakers wholly or mainly in Wales, that they get fair value for the use of resources consistent with competition law.
- 4.7. Charges should be transparent and predictable where possible. Ofwat should consider how to achieve this, including whether charging rules should provide clear guidance on how costs should be measured and on how common costs should be allocated and whether charges and/or the methods for calculating those charges should be published by undertakers.
- 4.8. Many existing bulk supply agreements are long-standing arrangements that have been in place for many years. In setting charging rules in respect of bulk supplies, Ofwat should consider transitional arrangements and in particular, whether and how new charging rules would apply to existing arrangements.
- 4.9. Where this neither conflicts with competition law nor our guidance related to NAVs and new entrants Ofwat should require companies' charges to reflect the costs arising from any agreement, so there is no cross-subsidisation of the undertaker receiving the supplies of water or sewerage services. Costs could include, but are not limited to, building / maintaining infrastructure, treating water, work to prevent or repair any environmental damage, work required to comply with relevant legislation, and any consequential costs. Ofwat's charging rules should promote effective, timely and proportionate consultation. Ofwat should encourage companies to understand and engage with their customers and in particular undertakers should be able to justify and explain their approach. Ofwat should consider how charging rules can be used to require companies to consult with their customers and stakeholders, including Welsh Ministers, Consumer Council for Water and Natural Resources Wales and explain the basis for setting their charges.
- 4.10. New agreements should include a mechanism for a periodic review of the terms of the agreement.

5. Guidance on charging rules for access to water networks

- 5.1. Water undertakers will recover charges from water supply licensees under agreements ("section 66D agreements" for the purposes of the Act). Water undertakers can charge water licensees for use of the water undertakers' networks for the supply of water to customers of water licensees. Section 66E of the Act (as substituted by the Water Act 2014) allows Ofwat to

issue charging rules about charges which may be levied by water undertakers under section 66D agreements.

- 5.2. Ofwat must issue rules about charges under section 66E of Act. Under section 144ZE of the Act, the Welsh Ministers must issue guidance to Ofwat about the principles to be applied by Ofwat in determining those charging rules. In addition, Welsh Ministers may, under section 66ED of the Act, provide guidance to Ofwat on the content of such charging rules. For supplies between an undertaker wholly or mainly in Wales and an undertaker wholly or mainly in England (or in either case, a person who would, if the person's application for an appointment or variation is determined in accordance with the application, be such an undertaker), guidance must be made jointly with the Secretary of State.
- 5.3. In setting charging rules in respect of access, Ofwat should consider the appropriate balance of incentives to ensure charges reflect the full cost of access, including impacts on existing customers. The Welsh Government expects Ofwat to ensure that access is not subsidised by existing customers.
- 5.4. Access charges should be transparent and predictable and Ofwat should aim to limit the scope for future disputes based on differences in the interpretation of the charging rules as far as possible. Ofwat should consider alternative means for achieving this, including how charges and/or the methods for calculating those charges should be published; and by ensuring any charging rules for access provide clear guidance on how costs should be measured and on how common costs should be allocated to access. Ofwat should also be clear about the relevance of the charging rules to combined supplies.
- 5.5. In setting charging rules in respect to access, Ofwat should consider transitional arrangements and in particular, whether and how new charging rules would apply to existing access arrangements. Ofwat should also consider actual or proposed arrangements for rules about non-price terms in access agreements, such as the Act section 66DA codes, to ensure consistency of the charging rules with those requirements.

6. Appendix - Summary of Welsh Ministers powers and duties to issue guidance on charges to Ofwat

Duties	Water Industry Act 1991 (as amended)	Water Act 2014
Welsh Ministers <u>must</u> issue guidance about the <u>principles</u> underlying charging rules issued by Ofwat under 66E [Access charges]	144ZE	38
Welsh Ministers <u>must</u> issue guidance to Ofwat on the <u>principles</u> applied in rules on charges schemes issued under 143B [Charges schemes]	144ZE(1)(c)	38
Welsh Ministers <u>must</u> issue guidance regarding the <u>content</u> of the rules under 144ZA [Developer charges – connections]	144ZD(1) – (2)	17
Powers		
Welsh Ministers <u>may</u> issue guidance about the <u>principles</u> to be applied by Ofwat in determining the contents of other documents produced by Ofwat about charges [General guidance on charges]	144ZE(4)	38
Welsh Ministers <u>may</u> issue guidance on the <u>content</u> of rules under 66E [Access charges]	66ED(1)	Sch. 2(5)
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>content</u> of charging rules issued under 143B [Charges schemes]	143E(1)	16
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>principles</u> applied in rules under 144ZA [Developer charges – connections]	144ZE(2)	38
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>principles</u> applied in rules under 40E [Bulk supply charges]	144ZE(2)	38
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>content</u> of charging rules issued under 40E [Bulk supply charges]	40I	8
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>principles</u> applied in rules under 110F [Sewerage mains connection charges]	144ZE(2)	38
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>content</u> of rules under 110F [Sewerage mains connection charges]	110J(1)	9
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>principles</u> applied in rules under 51CD [Charges for adoption of water infrastructure]	144ZE(2)	38
Welsh Ministers <u>may</u> issue guidance on the <u>content</u> of rules under Section 51CD [Charges for adoption of water infrastructure]	51CG	10
Welsh Ministers <u>may</u> issue guidance to Ofwat on the <u>principles</u> applied in rules under 105ZF [Charges for adoption of sewerage infrastructure]	144ZE(2)	38
Welsh Ministers <u>may</u> issue guidance regarding the <u>content</u> of rules under 105ZF [Charges for adoption of sewerage infrastructure]	105ZI	11
Ministers <u>may</u> issue guidance to Ofwat on the <u>principles</u> applied by charging rules issued in accordance with regulations under 66M [Water supply agreements]	144ZE(2)(c)	38