



Department
for Environment
Food & Rural Affairs

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Consultation on Charging Guidance to Ofwat

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Any enquiries regarding this publication should be sent to us at

chargingguidanceteam@defra.gsi.gov.uk

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i. This consultation

i.i This consultation seeks your views on the Government's Charging Guidance to Ofwat the independent economic regulator of the water sector. This consultation is issued under section 144ZE of the Water Industry Act 1991 as inserted by section 38 of the Water Act 2014¹: General guidance on charges. Ofwat must have regard to any guidance issued under this section by the Secretary of State when making *Charges Rules* that apply in areas that are wholly or mainly in England. Annex A on page 36 summarises the key changes to the existing regimes that are made by the Water Act 2014. This Guidance covers the rules which Ofwat may set, through their Charging Rules and any other relevant document, about the charges made by water and sewerage undertakers, water supply and sewerage licensees and new entrants in the future upstream markets.

Prior to issuing such guidance, the Secretary of State is required to consult the "relevant persons" on a draft of the Charging Guidance. The relevant persons are—

- Welsh Ministers;
- the Consumer Council for Water;
- any relevant undertakers likely to be affected by the proposed guidance;
- any water supply licensees or sewerage licensees likely to be affected by the proposed guidance;
- such other persons as the Minister thinks appropriate.

i.ii We welcome the views of all interested parties on any aspect of this draft guidance. This consultation will run until 6th August 2015. We will consider and act upon any feedback, with a view to laying the final guidance before both Houses of Parliament in autumn 2015. If at the end of 40 days if neither House has resolved that it should not be issued, it will be formally published on the GOV.UK website.

i.iii Our intention is to bring the Guidance into force to enable Ofwat's to issue *Charging Rules* in respect of water and sewerage undertakers' charges schemes in advance of the 2016 charging year.

¹ <http://www.legislation.gov.uk/ukpga/2014/21/section/38/enacted>

1. Introduction

The Water Act 2014 – a new framework for charging

1.1 The Water Act 2014 introduced a number of changes to legislation to support the Government's overarching policy objectives for the water sector. These legislative changes enable action to increase competition in both the non-household retail and upstream markets. The Act also sets out a new framework governing the regulation of water and sewerage charges. This provides the UK and Welsh Governments with new powers and duties to produce charging guidance to Ofwat; setting out a policy framework for Ofwat's approach to regulating charges. This Guidance document is issued by the UK Government in the areas of water and sewerage undertakers that are wholly or mainly in England. It covers the charges incumbent undertakers set for customers as well as those for other businesses that use the network such as licensees, inset appointees, self-lay operators and developers. It also covers the retail charges that may be levied by water supply and sewerage licensees. In setting its Charges Rules, Ofwat must have regard to this guidance.

1.2 The legislation requires that the Minister must issue guidance about the principles to be applied by the Ofwat in setting:

- rules under section 66E in relation to the charges which water undertakers impose on water supply licensees;
- rules under section 117I in relation to the charges which sewerage undertakers impose on sewerage licensees;
- rules under section 143B in relation to the charges schemes published by water and sewerage undertakers;

1.3 In addition to this, the Act provides that Minister may issue guidance about the principles to be applied by Ofwat in determining the provisions of:

- rules under section 40E in relation to charges imposed by a water undertaker under a bulk supply agreement with another undertaker and inset appointees;
- rules under section 51CD in relation to charges imposed by a water undertaker under an agreement for adopting a water main or service pipe at a future date;
- rules issued in accordance with regulations under section 66M imposed under a water supply agreement;
- rules under section 105ZF in relation to charges imposed by sewerage undertakers under an agreement for adopting a sewer, drain or sewage disposal works at a future date;
- rules under section 110F in relation to the charges that may be imposed by a sewerage undertaker on another undertaker or inset appointee under a main connection agreement;

- rules under section 144ZA in relation to charges which may be levied by water undertakers and sewerage undertakers for connections to, and the provision of, water mains, public sewers and some associated infrastructure.

1.4 Furthermore, the Minister may also issue general guidance about the principles to be applied by Ofwat setting rules about charges that may be imposed by either water and sewerage undertakers or water supply or sewerage licensees in other documents (e.g. licence conditions, deemed contracts, non-statutory guidance, etc.).

1.5 Ofwat's charging rules will be subject to public consultation. The Minister² has a power to direct Ofwat not to issue the rules, for example if he or she considers that the rules are not consistent with the Government's policy. Where the Government issues revised guidance, the Act requires that Ofwat should review and, if necessary revise, the relevant charging rules.

1.6 This guidance builds upon the *Charging Principles* that were published in November 2013 to inform discussions during the passage of the Water Bill³. The Government's broader priorities for economic regulation in the water sector are set out in greater detail through the *Strategic Policy Statement to Ofwat*. This is statutory guidance which establishes the policy priorities that Ofwat has a particularly important role in delivering; and against which it will be held to account in respect of its independent regulatory decisions. This Charging Guidance should, therefore, be read alongside the Government's *Strategic Policy Statement to Ofwat*.

Changes to the process for setting charging schemes

1.7 This Guidance will replace the Government's previous *Charging Guidance to Ofwat* which was issued in 1999 and which set the framework for Ofwat's previous approach to charges schemes. In line with this Guidance, Ofwat has new powers to issue rules on the charges schemes that incumbent water companies use to charge customers for water supply and sewerage services. This will replace the current system under which Ofwat annually approves companies' charges schemes on an individual basis. The objective is to reduce bureaucracy and increase accountability, while ensuring that incumbent water companies' charges schemes are consistent with Government policy. The intention is to have Ofwat's charges schemes rules in place in advance of the charging year 2016/17.

1.8 The Government has already issued specific guidance on a range of issues related to tariffs and charges schemes such as: *Company Social Tariffs Guidance* and the *Guidance to Water and Sewerage Undertakers in relation to Concessionary Schemes for Community Groups for Surface Water Drainage Charges*. This guidance remains in force

² in relation to incumbent water and sewerage companies wholly or mainly in England; Welsh Ministers have the same powers in relation to companies wholly or mainly in Wales and will issue separate Guidance.

³ https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/253982/pb14048-charging-principles.pdf

and both Ofwat and the industry should continue to have regard to current and future iterations, alongside this *Charging Guidance*.

Detailed charging guidance

1.9 In addition to this overarching statement of charging policy and principles, the Water Industry Act 1991, as amended by the Water Act 2014 provides the Secretary of State and Welsh Ministers with powers to issue further, more detailed guidance on each of the particular charging regimes issues listed in paragraphs 1.2 and 1.3 above. In many areas we may consider that the overarching statement of principles published here is sufficient, in others we may take the view that further detail is required. For example, Defra intends to use the power in section 144ZD to publish more detailed guidance on the charges that incumbent water companies may make to developers.

A phased approach to reform

1.10 The Government has always been clear that our programme of reforms to the water industry would be introduced in a phased, evolutionary manner. In line with this, the *Charging Guidance*, in combination with Ofwat's charging rules, will ultimately replace the "costs principle" which currently regulates interactions between water undertakers and other licenced businesses that use the network. Due to the different timeframes for implementing the Government's competition reforms in the retail and upstream markets, we will undertake a phased commencement of the legal powers that will remove the costs principle. Ofwat has already set separate wholesale and retail price limits and companies have reflected these different boundaries in their charges. The intention is to remove the costs principle in respect of the water supply market for non-household retail services in advance of retail market opening in April 2017. The costs principle in respect of the upstream markets will remain in place until such time as the policy approach to the detailed implementation of upstream reform has been established by the Government and the necessary framework of charging guidance, charges rules and market codes are ready to take its place.

1.11 The Government's approach to charging will need to evolve as the competitive markets develop and will need to be reviewed to reflect changes in Government policy and to take account of future price controls. In particular, we recognise that it may be necessary to issue further guidance in respect of the upstream markets as the plans for these become more concrete and to take account of abstraction reform and other relevant policy developments. The time frame for Ofwat to issue charging rules in respect of these emerging regimes is, therefore, expected to reflect this phased approach to implementation.

1.13 Conversely, as some competitive markets develop over time, the need for detailed charging rules may diminish. For example, the Government takes the view that in the early years of the new retail market Ofwat must keep under review the development of charges and their implications for different groups of customers. It is essential both for individual

customers and for the credibility of the market as a whole that all non household customers should be able to switch in order to access a good retail service at a fair price. The Government expects Ofwat to ensure that the retail charges imposed by licensees support this outcome for all groups of customers. However, as competition becomes more established, the Government recognises that requirement for such regulation of retail charges may reduce.

The Government's policy priorities for the water sector

1.14 It is the Government's responsibility to set the strategic framework and policy priorities within which economic regulators such as Ofwat operate.⁴ The Government's policy priorities for the water sector are set out in the Water White Paper: *Water for Life*, published in December 2011. This identified the challenge of increased water scarcity due to climate change and demographic trends and highlighted the need for increased resilience, long term planning and improved customer choice. The Government's policy framework for economic regulation of the water sector is set out in its *Strategic Policy Statement* to Ofwat.

1.15 The Government is committed to stable and predictable regulatory frameworks to protect consumers, facilitate efficient investment and contribute to sustainable growth. In particular, our overarching policy objectives for the water sector are:

- **Long-term resilience:** a policy framework which drives the water sector and significant water users to plan for a future when water resources come under more pressure and take action in response.
- **Growth:** action to encourage continued investment in our water and sewerage systems to build resilience and support growth. The stable regulatory regime has proved attractive to investors, and our evolutionary and measured programme of reform will ensure that continues.
- **Environmental protection:** an ambitious agenda for protecting our rivers, lakes, bathing waters, groundwater and estuaries, reforming the abstraction regime and improving water quality by reducing pollution and restoring flow levels, working closely with local communities to tackle problems at a catchment level.
- **Affordability and reliability:** ensuring that the interests of customers are at the heart of decisions about the water sector, ensuring they receive good service now and in the future with bills that remain good value.
- **Efficiency:** we are reforming the water sector to encourage innovation and increase efficiency, increasing competition as a way of delivering better outcomes for customers

⁴ [Principles for Economic Regulation, BIS, April 2011](#)

and for the environment; build an understanding among consumers of the economic and environmental cost of their water use, and the scope for increased water efficiency.

1.16 The Government's Charging Guidance to Ofwat is one of a number of policy tools available to support the delivery of these policy objectives.

2. The Government's objectives for water and sewerage charging

2.1 The Government has four overarching objectives for charging in respect of water and sewerage services. Each of these four objectives has equal weight and will need to be reflected by the regulator in determining the *Charging Rules*:

- Fairness and affordability;
- Environmental protection;
- Stability and predictability;
- Transparency and customer-focused service.

The Government recognises that in practice, trade-offs will need to be made between these objectives and the appropriate balance between them will be context-specific.

2.2 In order to distinguish between the various charging regimes covered by this guidance, it has been structured into the following four sections:

1. Charging Schemes
 - a. Charges Schemes for Household Customers;
 - b. Charges Schemes for Non-household Customers
2. Charges in the new non-household Retail Market
3. Charges in the current and future Upstream Markets
4. Developers Charges

The four overarching principles set out above are relevant across all of these charging regimes. The specific application of the principles to the relevant charging regime is covered in greater detail in each of these sections. The Government's general objectives with respect to these principles are summarised here:

Fairness and affordability

2.3 Ensuring that all customers get a fair deal, both now and in the future, is the principle underpinning the Government's overall approach to charging. The Government is acutely aware of the range of pressures on household budgets and the need to keep costs down for businesses. Ofwat's core role is in regulating the prices that water companies can charge their customers – they do this every five years through the Price Review process. A stable regulatory regime has an important role in keeping customer bills fair and affordable by supporting low-cost, long-term investment in the sector. Ofwat also has

a role in promoting effective competition in relation to the provision of water and sewerage services - where this supports their duty to further the interests of consumers.

2.4 Whereas the Price Review places limits on the total amount of revenue water and sewerage undertakers may recover from their household and non household customers in respect of both wholesale and retail services, the regulator's Charging *Rules* will set the framework within which companies will be responsible for apportioning charges between customers. In setting their *Charging Rules* Ofwat must have regard to their particular duties under the Water Industry Act 1991 to protect certain groups of customers including:

- individuals who are disabled or chronically sick;
- individuals of pensionable age;
- individuals with low incomes;
- individuals residing in rural areas.

2.5 These specific duties do not limit Ofwat's scope to consider the particular needs of any group of customers and of customers as a whole. Ofwat is expected to keep under review the implications of their charging policies on different classes of customer. Ofwat also has duties to secure that there is no undue discrimination and that no undue preference is shown in the setting of charges. Ofwat's duties are to further the interests of both current and future customers. The Water Act 2014 reinforced this responsibility to future customers by adding a further statutory duty to the Water Act 1991 to secure long-term resilience.

Environmental protection

2.6 A central message of the Government's Water white Paper: *Water for Life* was that the efficient use of water resources is fundamental to securing the long-term resilience of water supplies and to protecting the water environment. The Government is committed to achieving the right balance between long-term planning, environmental regulation and the use of market mechanisms to secure the most efficient use of scarce water resources.

2.7 In setting *Charging Rules* Ofwat must have regard to their duties to secure the long-term resilience of water undertakers' supply systems and sewerage undertakers' sewerage systems as regards environmental pressures, population growth and changes in consumer behaviour. The purpose of this duty is to promote long-term thinking in the water industry and encourage the sustainable management and use of water resources. Ofwat must also have regard to their duty to contribute to the delivery of the Government's sustainable development objectives.

2.8 Charging can play a key role in securing the economically and environmentally efficient use of resources; encouraging innovation and ensuring that environmental goods are costed appropriately. There are substantial cross-subsidies inherent in the water sector, due to the reliance of all customers on sufficient resources and a resilient network. In many cases unwinding these cross subsidies will be of little practical benefit and may

lead to bill instability; creating winners and losers without delivering any measurable policy benefit. However, in some cases it may be beneficial to use targeted price signals to improve recognition of environmental costs. For example, if a very large water user is making a decision about where to locate new premises, it would make sense for them to consider the benefits associated with areas where water is plentiful. Currently, such incentives are minimal. However, such tools must be used appropriately to avoid the creation of perverse incentives and to ensure that any change is in the overall interest of customers and the environment.

2.9 In this context, the Government recognises that innovative tariff structures can send positive price signals and improve economic and environmental efficiency. This might involve pricing to reflect seasonal peaks or incentivise collection and use at times of lower demand. Rising block tariffs can also have a role in encouraging customers to consider their use of water. However, as above, the introduction of such tools needs to be properly evaluated, especially where costs would be incurred as part of implementation. Well-designed small-scale tariff trials can provide important evidence to guide decisions on tariff design. A balance will need always to be struck with the principles of fairness and affordability and stability and transparency.

Stability and predictability

2.10 Customers strongly value stable and predictable bills and this is therefore a particular priority for Government. In setting *Charging Rules*, the Government expects Ofwat to take action to ensure that any changes in the charges faced by customers from year-to-year (where water usage does not change markedly) are proportionate and reflect the Government's overarching policy objectives for the sector.

2.11 Ofwat should set a clear expectation that in, developing their charges schemes, the companies must undertake a proportionate assessment of the impacts of any significant incidence effects on customers as a whole or on groups of customers and act on the results.

2.12 In addition, when considering any substantive changes in regulatory direction that are designed to drive changes in company behaviour, Ofwat should work with the industry to develop a proportionate assessment of the impact of this change on customers as a whole and on different customer groups and take action in the light of that assessment. Wherever reasonably possible, changes should be phased in and handled carefully by companies to ensure that all customers continue to face predictable and stable bills.

2.13 Ofwat must take a proportionate regulatory approach that recognises the costs and burdens that regulation can place on water companies and their customers. In order to facilitate stable charges, Ofwat should seek to be consistent in its general approach to charging with any changes well signalled and subject to appropriate consultation with both the companies and the customers affected.

Transparency and customer-focused service

2.14 The Water White Paper set out the Government's ambitions for a water sector that places the customer at the heart of everything it does. It is essential that customers' needs are taken into account when devising charges.

2.15 Ofwat's *Charges Rules* should seek to ensure that all charges are appropriately simple and presented in a way that customers find relevant and easy to understand. This principle is equally relevant to charges for non-household customers in the new retail market, and charges to developers or for bulk supplies or upstream services.

Q1: Do you agree that the Government's overarching objectives for charging should be *fairness and affordability, environmental protection, stability and predictability* and *transparency and customer-focused service*?

Q2: Are there any other comments that you would like to make about the Government's overarching objectives for water and sewerage charging set out in Chapter 2?

3. Guidance on charges schemes

3.1 Every five years, Ofwat sets revenue requirements for each water and sewerage or water only company, and uses these to determine the limits on what companies may recover from their customers. In doing so, it is Ofwat's responsibility to both protect consumers and ensure that the companies are able to finance their operations. It is the responsibility of the water companies to fix their charges in accordance with the price limits set by Ofwat. Every year each water company must publish a charges scheme which sets out how charges will be apportioned between different customer groups.

3.2 The Water Industry Act 1991 together with condition D of companies' Instruments of Appointment sets out the legal framework within which water and sewerage undertakers may make such charges schemes. It establishes that charges schemes may fix the charges to be paid for any services provided by the undertaker in the course of carrying out its functions⁵; and make provision with respect to the times and methods of payment of such charges. Charges schemes may make different provision for different cases, including different provision in relation to different circumstances or localities. These schemes do not place any constraint on the capacity of undertakers to enter into bilateral agreements with customers (provided the premises served is not classed as a dwelling) where appropriate.

3.3 Since 1999, there has been a legal requirement for Ofwat to approve each company's charges scheme before it can take effect. However, Section 16 of the Water Act 2014 includes provision to remove the approval requirement and to replace this with a framework of rules and guidance. The objective is to reduce red-tape and to make the companies accountable to their customers for the charges they set. Starting from the charging year 2016, the approval requirement will be replaced with a power for Ofwat to set *Charging Rules*. This is supported by a power of direction to be used in the event that Ofwat considers that a charges scheme does not comply with their published rules. This section of the Act also creates a new duty for Ofwat to issue rules requiring undertakers to consult the Consumer Council for Water about proposed charges schemes. In setting their *Charging Rules* Ofwat must have regard to any *Charging Guidance* issued by the Government under section 143E or 144ZE of the Water Industry Act 1991. Should the Government issue amended guidance, Ofwat must consider whether their rules also need amending and respond accordingly.

3.4 The Water Act 2014 introduced reforms to the market for non-household retail services aimed at increasing choice for non-household customers. In line with this Ofwat has set four separate caps as part of the current Price Review:

1. Household retail;
2. Non-household retail;

⁵ Including the reception, treatment, and disposal of trade effluent in the case of a sewerage undertaker

3. Wholesale water; and
4. Wholesale sewerage.

3.5 This guidance covers both wholesale and retail charges, as a result of this extension of competition in the non-household retail market, we have set out separate guidance on the *Charging Rules* Ofwat issues on charging schemes for household and non-household customers.

3.6 There is also further, separate Guidance on the charges that water and sewerage undertakers and water supply or sewerage licensees may make in the retail market.

4. Guidance on charges schemes for household customers

4.1 Under section 2 of the Water Industry Act 1991, Ofwat has a duty to protect the interests of consumers, including (where this is appropriate) by promoting effective competition in the provision of water and sewerage services. As set out on page 8, Ofwat must have particular regard to the interests of several groups, including disabled or chronically sick customers; those of pensionable age; those on low incomes; and rural customers. These responsibilities apply equally to both existing and future customers.

Fairness and affordability

4.2 Ensuring that all customers of water and sewerage companies are charged fairly for a high quality service is at the heart of the Government's policy priorities. The Government expects the most vulnerable groups in society to be the subject of special protections; and there are specific statutory duties on Ofwat in this regard. These are supported in legislation, for example by the Vulnerable Groups Regulations which establish the basis for the WaterSure scheme. WaterSure caps the water bills of metered customers who are in receipt of certain benefits if they have a large family or a member of their household has a medical condition that requires significant additional water use.

4.4 The Government's *Company Social Tariffs Guidance* enables water companies to include social tariffs in their charges schemes, reducing charges for individuals who would otherwise have difficulty paying their water bill in full. The Government is clear that water companies are best placed to take decisions around the design of local social tariffs as part of their charges schemes so that they can take account of local circumstances and needs, and the views of their customers. Ofwat's Charging Rules should cross refer to the Social Tariffs Guidance; making it clear that any well designed Social Tariff that complies with the Social Tariffs Guidance is to be welcomed.

4.5 The Government also expects Ofwat, within the scope of their duties, to encourage water companies to know their customers and to set out in their charges schemes appropriately targeted tariffs and payment plans designed to help those customers that may struggle to afford their bills and reduce the costs of bad debt to all customers. This should include clear strategies to minimise the numbers falling into arrears and to agree payment arrangements to address arrears with as many customers as possible.

Environmental considerations

4.6 The *Water White Paper* recognised the important role to be played by promoting a more efficient use of scarce water resources in securing the long-term health and resilience of the water environment. Metered charges are amongst a number of tools that can help promote the efficient use of water. Metering can also help make water more affordable, as customers only pay for the water that they use. This can help to incentivise

lower water usage which can help control prices for households both individually and for all customers through reducing the demand for water and the need to invest in new infrastructure. In setting charging rules, Ofwat should recognise the role that volumetric charging can play in influencing consumer behaviour. However, because circumstances are very different in different regions and because the responsiveness of demand to changes in price for some types of customer can be very limited, the Government does not take a blanket approach to metering policy. The Government's policy in relation to volumetric charging is to encourage water companies to do more to promote metering to those who would benefit, whilst bearing in mind the potential impact on some struggling customers with high water use. Charges schemes should always make clear the circumstances in which companies will require measured charges to be applied.

4.7 The Water Industry (Prescribed Conditions) Regulations 1999 allow companies to install meters in cases in which customers are using significant amounts of water for non-essential purposes. Similarly, where an area is seriously water-stressed, companies can decide to implement universal metering as one way of reducing demand. Serious Water Stress is a formal designation, based on scientific advice from the Environment Agency, that highlights when an area may not have enough water available to meet demand.⁶ In assessing this option the companies will need to consider all of the available demand management options and decide on the best way forward in consultation with their customers. Proposals for universal metering schemes must also be subjected to cost/benefit analysis and customer engagement through the statutory Water Resources Management Planning process.

4.8 In setting charging rules, Ofwat should always seek to ensure that any transition to metering by a company is handled with care; recognising that water bills may rise for some customers who move to a meter. It should make sure that, wherever appropriate, measures, such as transitional tariffs are put in place by the companies to support customers through this change and to protect them from sharp price rises. These should also be combined with social tariffs where appropriate. The Government's view is that any undertaker that chooses to introduce a universal metering programme across all or part of its operating area should seriously consider including a company social tariff in its charges scheme⁷. This would address long-term affordability issues that may arise from the unwinding of the cross-subsidies inherent in charging for water according to the rateable value of a property.

4.9 Just as the efficient use of water resources links customer charges with pressures on the environment, so too does the approach to drainage. As part of its commitment to protect people and property from flood risk the Government expects sustainable drainage

⁶ <https://www.gov.uk/government/publications/water-stressed-areas-2013-classification>

⁷ This is in addition to any transitional tariff or support that an undertaker brings forward as part of an area-wide roll-out of metering

systems (SuDs) to form a normal part of Undertakers' drainage networks, wherever this is appropriate and cost effective.

4.10 To fulfil their statutory duty water companies may construct, maintain and operate drainage systems which relieve the public sewer. Such SuDs are part of a water company's functions, and can be financed through charges contained in a water company's ordinary charges scheme with maintenance costs funded through the surface water drainage element of sewerage bills.

4.11 As well as demonstrating a wide range of environmental benefits, SuDs can also help to maintain a downward pressure on household bills by reducing pressure on drainage systems and reducing the need for additional investment in new sewers. In addition to SuDs which form part of the company's network, water customers can also reduce their sewerage charges by diverting their surface water away from the main sewer e.g. by constructing a soak-away. Where a customer can demonstrate that their surface water does not drain into the network they are entitled to a surface water drainage rebate. The Government expects the water industry to play their part in innovative and strategic approaches to surface water management and Ofwat should encourage water companies to raise awareness amongst their customers of the environmental and economic benefits of SuDs.

Stable and predictable charges

4.12 Household customers strongly value stable and predictable bills. Accordingly, the Government expects Ofwat to take action to ensure that any changes in the charges faced by customers from year-to-year (where water usage does not change markedly) are proportionate and reflect the Government's overarching policy objectives for the sector. Charges will evolve over time, but any new regulatory drivers that may result in marked swings in charges should be carefully considered through a published Impact Assessment. The phasing in of changes over time, through the use of devices such as glide paths, can be useful in managing incidence effects on customer bills. Where some incidence is unavoidable, sensible handling strategies need to be put in place by companies to communicate with their customers to explain the changes and to provide targeted support.

Transparent and customer-focused charging

4.13 Household customers have a legitimate expectation that they know where their money goes, and why. Ofwat's rules should encourage the companies to separate out the different elements that make up the overall charge in a way that customers will find transparent and relevant.

Q3: Do you agree with the Government's policy priorities for charges schemes for household customers outlined in Chapter 4?

5. Guidance on charges schemes for non-household customers

5.1 Whilst all non-household customers in England will have the option to switch their supplier of retail services from April 2017, the greater part of non-household customers' charges will continue to reflect the 'wholesale' costs of sourcing, treating and transporting water and receiving, transporting, treating, and disposing of wastewater. Ofwat's statutory duties under section 2 of the Water Industry Act 1991 to protect the interests of consumers continue to apply equally to non-household customers. The Government recognises that non-household customers have very similar expectations to those of household customers in respect of fair, affordable, stable, predictable and transparent charges. All of the relevant points in the section above should, therefore, be applied equally to non-household customers. In particular:

- Non-household customers value stability and predictability in their water bills just as household customers do. These are important for organisations to be able plan and forecast their operational costs and run their organisations effectively.
- Charges should be transparent and easy to understand. Charges should always be presented in a clear, simple way which minimises any administrative burden on business customers.
- Ofwat has particular responsibilities with respect to rural customers and these are also relevant to non-household customers located in rural areas. Supporting rural business is a priority for government. Ofwat's charging rules should seek to secure that rural businesses are not unduly disadvantaged as a result of their geographical location.

5.2 In issuing their *Charging Rules* Ofwat should have due regard for the broad diversity of non-household customers. This includes small, large and micro businesses, charities and non-for-profit organisations and public sector bodies. These diverse customers will have very different needs with many small and micro-businesses and other small organisations having more in common with households than with larger businesses and are likely to need extra protection, especially in the early years after market opening.

Cost-reflective surface water drainage charges

5.3 Surface Water Drainage (SWD) charges cover the removal and treatment of rain that falls on impermeable areas such as roofs and car parks and drains into public sewers. Historically such charges for non-household customers were typically based on the rateable value of a property. In recent years Ofwat has encouraged (but not required) companies to switch to charging for SWD according to site area. Whilst the switch to site area charging is revenue neutral for a company's customer base as a whole, in some parts of England it has resulted in significant bill increases for some organisations. This can have a particular impact on organisations with premises that typically have low rateable values and large impermeable site areas, such as churches, village halls, and community sports clubs.

5.4 The Government recognises the need to reduce surface water run-off and the importance of promoting sustainable drainage systems. However, the Government does not consider that substantial increases in SWD charges for community organisations are in the public interest where these could lead to such organisations closing or cutting back on the valuable services that they provide to society. To address such concerns, the Flood and Water Management Act 2010 includes measures that enable the companies to operate concessionary schemes for community groups for surface water drainage charges as part of their charges scheme. The Act does not prescribe which community groups must be included in any scheme. The legislation can potentially apply to any organisation that benefits its local community.

5.5 The legislation also enables the Secretary of State to issue guidance to companies which operate wholly or mainly in England in respect of concessionary schemes. In 2010 the Government published *Guidance to Water and Sewerage Undertakers in relation to Concessionary Schemes for Community Groups for Surface Water Drainage Charges*. This is designed to make it clear which classes of community organisations the Government believes to be appropriate for inclusion in concessionary schemes whilst, at the same time, allowing undertakers flexibility to take account of local circumstances. Both Ofwat and the undertakers must have regard to this guidance.

5.6 Since issuing this guidance, concerns from community groups such as those listed above have diminished substantially. However, fresh concerns have arisen in relation to other organisations that provide a wider benefit to society that are not specifically covered by the guidance. These include: parks and other public spaces, cemeteries and crematoria, schools and hospitals. The Government strongly supports organisations taking a more sustainable approach to drainage, but recognises that opportunities to do so may be subject to practical or budgetary limitations. At the same time, the implications, of increasing the charges to such organisations may not be in the wider public interest.

5.7 The Government takes the view that the introduction of area-based charging should result in a recognisable benefit to customers as a whole and should not have an unduly negative impact on organisations that provide a wider benefit to society. Before finalising

this Guidance, therefore, the Government proposes to undertake further discussions with the affected parties to explore whether there would be any benefit in undertaking a review of its *Guidance to Water and Sewerage Undertakers in relation to Concessionary Schemes for Community Groups for Surface Water Drainage Charges*. Meanwhile, Ofwat is expected to encourage companies to use their discretion in applying area-based surface water drainage charges and to pay particular attention to the potential implications for organisations that provide a wider benefit to society.

Q4: What are your views on the guidance on charges schemes for non-household customers provided in Chapter 5?

6. Guidance on charges in relation to the retail market

Setting retail charges

6.1 The Water Act 2014 set out a range of reforms with the objective of delivering increased resilience, increased customer choice and economic growth in the water sector. One of the central reforms for achieving these objectives is the extension of retail competition in the non-household retail market. This will mean that all non-household customers—i.e. businesses, public sector organisations and charities—will be able to switch from their undertaker to another supplier that is licensed to provide specified retail services.

6.2 These non-household customers will be able to contract with a retailer to provide a level of service at an agreed price. However, Ofwat will still be required to set rules on charges for those customers who have not chosen to switch – these include customers that are still with their incumbent undertaker and customers that have been transferred following an exit. In addition Ofwat will be required to keep under review the operation of the market and to assess the need for back-stop price protections for all customers in the retail market and for specific groups of customers. Charges rules addressed in this section therefore relate to the relationship between the retailer (undertaker or licensee) and non-household customers.

Fairness and affordability

6.3 As the new retail market develops, the Government is clear that Ofwat must continue to keep the market under review and where necessary take action to ensure that the retail charges received by non-household customers remain both fair and affordable.

6.4 As part of the 2015 Price Review process Ofwat has set average revenue controls for all water and sewerage companies. Based on these, all water and sewerage undertakers have set “default tariffs” which include both a wholesale charge and a specified retail margin which will apply to the charges they set for non-household customers in their area of appointment. Ofwat has not yet taken a final decision about whether (and if so how) these default tariffs will apply to licensees operating in the competitive market.

6.5 Before the decision was taken to enable undertakers to choose to exit the retail market, the assumption had been that all switching customers would retain the option to switch back to the undertaker on default tariff terms. In this way, default tariffs would also have had an influence on the charges levied by all licensees for their retail services. However, enabling exit to take place means that this back-stop protection will no longer be available to customers in all parts of the country.

6.6 The Government considers that it is essential both for the security of individual businesses and for the credibility of the market as a whole that all non-household customers should be in a position to switch suppliers; and that in doing so they are able to access a good retail service at a fair price. To secure this outcome, Ofwat is therefore expected to set out in *Charges Rules* the appropriate level of back-stop protections for the retail customers of all licensees.

6.7 While the broad expectation is that the requirement for price protection is likely to diminish over time, as customers opt to move onto contracts that better suit their particular needs, the Government considers that some form of backstop protection will be important at the outset to enable customers to negotiate the best deal as the market matures. Ofwat should also consider that different classes of customers may have different requirements in this regard. It is generally recognised that SMEs have a number of features in common with household customers in the way they engage in the market. Ofwat has a statutory duty to have particular regard to the needs of rural customers. The Government, therefore, expects Ofwat to keep the need for price protection for non household customers under review as the market develops and, where appropriate, to produce and publish an assessment of the impacts of any changes to their rules on particular groups of customers such as SMEs or those located in a rural area.

6.8 In regulating charges in respect of the non-household retail market Ofwat will be responsible for keeping under review the retail margin they have set through the Price Review in order to ensure that it enables efficient retailers to enter the market and facilitates the effective operation of the market.

6.9 The Government is currently consulting on its proposed approach to implementing retail exits. This proposes that Ofwat should put in place a deemed contract setting out both the price and non-price terms to which the transferred customers of an exited undertaker should be subject. The expectation is that at market opening the deemed contract would include price terms which are equivalent to those that the customer would have been receiving from the undertaker had they not chosen to exit. The Government recognises that some degree of managed flexibility may be required in instances where it can be demonstrated that the undertaker had set their tariffs at an unsustainably low level, Ofwat will need to take steps to address this eventuality.

6.10 Given the possibility that a number of undertakers may choose to exit the retail market at or after market opening, further consideration needs to be given to the future regulation of charges in the retail market. The Government expects Ofwat to set out rules governing how price terms will continue to be secured through the deemed contract post 2020 to ensure equivalent levels of protection for the customers of undertakers and the customers of acquiring licensees.

Environmental considerations

6.11 The efficient use of scarce water is essential for the long term resilience of both the environment and of the economy. One of the expectations of the new retail market is that it will incentivise more targeted and innovative approaches to the provision of efficiency advice.

6.12 In setting *Charging Rules* the regulator must ensure that both undertakers and licensees give due regard to any current or future guidance which Defra may issue on concessionary schemes for community groups' surface water drainage charges. This sets out the grounds for a concessionary scheme for community groups where these groups are based on impermeable sites draining surface water to public sewers.

Stable and predictable charges

6.13 Non-household customers place a high value on the stability and predictability of their water bills. These are important for organisations to be able plan and forecast their operational costs and run their organisations effectively. The price terms built into default tariffs and the deemed contract can offer protection from abrupt changes in bills. Whilst these will need to evolve over time as the competitive market develops, the regulator should ensure that it continues to protect customers from sharp changes and undue levels of price volatility.

6.14 The regulator will need to use the tools at its disposal to ensure that any moves towards greater cost reflectivity of retail charges are introduced in a measured fashion and are to the overall benefit of all customers. The regulator should also limit the extent and impact of de-averaging on retail charges on particular groups such as rural customers. The Government is clear that no particular category of customer should be unfairly disadvantaged by the extension of competition into the non-household market.

Transparent and customer-focused charging

6.15 The information provided on charges should be sufficient to allow non-household customers to understand how their overall charge has been arrived at and to be able to consider options for switching as well as for improving the efficiency of their water use and reducing the cost of their bill in the future. Charges should also be communicated in such a way that non-household customers can have a reasonable idea of what their bill will be ahead of receiving it.

6.16 There may be benefits from standardisation of some aspects of tariffs and charging between companies to ensure a reasonable approach can be set out in certain areas of the market codes and to address barriers to entry. However, this could lead to incidence effects for some customers', as well as reducing the scope for innovation in charging structures. In setting *Charging Rules* Ofwat will need to give careful consideration to the balance between the benefits from any move towards greater standardisation on

customers as a whole and the impact on individual customers or particular groups of customers.

6.17 Retail competition is designed to improve water company performance; driving efficiency and improving customer service for both household and business customers. Ofwat will continue to use the Price Review process to protect households and ensure that the charges they pay are fair and transparent. It remains an important point of principle that households will not pay for the implementation of the competitive market.

Rules on ‘special charging arrangements’ governing interactions between wholesaler and retailer

6.18 Through the Price Review 2014 Ofwat has agreed wholesale price limits with each water and sewerage undertaker. These set the revenue cap that a wholesaler may make for wholesale services it will provide to those retailers. These wholesale tariffs that will be set by the undertakers will be the same for all retailers’ customers of the same class who receive the same wholesale service. However, the Water Industry Act 1991 as amended by the Water Act 2014 identifies a number of areas where the Government may issue guidance to Ofwat on charges between the wholesaler and retailer. In general these are areas where there may be a need to secure an ongoing benefit to customers where they take action to reduce pressures on the wholesalers network or resources. *Charges Rules* addressed in this section therefore relate to the relationship between the retail licensee and the wholesaler.

6.19 Undertakers are able to negotiate special charging agreements with their non-household customers under section 142(2)(b) of the Water Industry Act 1991. These agreements fall outside of the usual terms set out in the undertaker’s charges schemes and tend to be with large users of water or customers that impose a heavy burden on an undertaker’s sewerage system. These agreements may include negotiated discounts or additional payments in return for additional investment made by the undertaker on behalf of the customer. Condition E of undertakers’ licences require that undertakers do not show any undue preference or unduly discriminate between customers when entering into these agreements. Ofwat must have regard to the Government’s policy objectives set out in this Charging Guidance under new section 144ZE(4) of the Water Industry Act 1991 if it wishes to update this licence condition or produce any other documents relevant to special charging agreements. It is the Government’s view that the special charging regime should be used in such a way as to incentivise efficiency and innovation, and promote resilience in the water system.

6.20 The Water Act 2014 introduced two important reforms to the special charging regime. Firstly, undertakers are now required to notify Ofwat when it makes such agreements with its customers. Ofwat is required to publish these notifications in its official register. This reform was introduced to increase transparency around these agreements and to introduce consistency with the new charging regime for licensees (see below).

6.21 Secondly, Ofwat's charging rules under new section 66E(3) and 117(I) must include provisions that will allow non-household customers with special charging agreements to be able to switch to a licensee and still retain the same level of wholesale charge.

6.22 Undertakers that exit the retail market will no longer be able to directly negotiate special charging agreements with non-household customers. However, once non-household customers have switched or have been transferred as part of an exit, their licensee may negotiate a special discount from the wholesale charge under sections 66EA and 117J of the Act where a non-household customer takes steps to reduce pressure on water or sewerage networks (such as where customers reduce their water-use during peak demand periods, store and recycle surface water).

6.23 A section 117J discount can also be applied to trade effluent charges where a discharger reduces pressure on treatment works, etc. As with the revised special charging agreements, undertakers will be required to report these discounts to Ofwat and the details will be published on Ofwat's register. Ofwat may issue charging rules about these wholesale discounts and in doing so must have regard to this Charging Guidance or any other guidance issued by Ministers. The Government wants the rights to negotiate discounts to stimulate markets for innovative water efficiency goods and services and to promote resilience in networks. However, we do not want to see ongoing charges to other customers to increase because of these discounts.

6.24 A similar provision, under section 43 of the Flood and Water Management Act 2010 stipulates that an undertaker's charges scheme may include provisions to reduce charges to community groups in respect of surface water drainage from their property where these are based on area. Section 43 of that Act 2010 also requires undertakers and Ofwat to have regard to any guidance published by ministers. Following the opening of the new retail market, it is expected that in cases where community groups switch to a licensee or are transferred as part of an exit the discount will be applied to the wholesale charge that is passed to the licensee. It is expected that licensees will help community groups to be aware of and to obtain these discounts, so that they still benefit from these while participating in the competitive market.

6.25 In all of these cases the discount represents a part of the wholesale charge. This discount must always be passed on to the customer by the retailer.

Q5: Do you think the guidance on charges in relation to the retail market in Chapter 6 will be appropriate for regulating charges when the new retail market for non-household customers opens in April 2017? If not, how could it be improved?

7. Guidance on charges in relation to the upstream market and for the use of water undertakers' networks

7.1 Under the changes brought about by Water Act 2014 there are a number of areas relating to the upstream market where the Government is required to issue guidance to Ofwat on charging. These include:

- Charges for the use of an undertaker's water supply or sewerage system by participants in the upstream markets;
- Charges for the sale of water by a person that is not an undertaker into an undertaker's system.

7.2 The Government has always been clear that our programme of reforms to the water industry would be introduced in a phased, evolutionary manner. The purpose of the guidance issued at this time, therefore, is to aid stability and transparency by setting out, at a high-level, the parameters within which we expect our approach to upstream to develop. We recognise that it will be necessary to issue further guidance in respect of the upstream markets as these plans become more concrete. The timeframe for Ofwat to issue charging rules in respect of these emerging regimes will reflect this phased approach to implementation.

7.3 Work to establish the detailed shape and scope of upstream market reform is currently underway. The Government is committed to ensuring that the introduction of upstream reform will occur in conjunction with abstraction reform. These markets will not be in place until beyond 2019 and the relevant reforms are likely to be introduced in a phased fashion. As a consequence, we will undertake a phased commencement of the legal powers that will remove the costs principle. The costs principle in respect of upstream markets will remain in place until such time as the policy approach to the detailed implementation of upstream reform has been established by Government and the necessary framework of revised charging guidance, charges rules and market codes are ready to take its place.

7.4 It follows therefore that until such a time as this more detailed policy and regulatory framework is in place, the costs principle, within the wider context of competition legislation will continue to apply to wholesale access pricing in the existing upstream markets.

Upstream charges – high level principles

7.5 Increasing the scope for entry in key parts of the market for upstream water and sewerage services is just one part of the Government's wider agenda for securing the long-term resilience of our water supplies and the water environment, which was set out in the Water White Paper. This includes, for example, the statutory water resources

management planning process and our plans for long-term reform of the abstraction regime. The common theme across this agenda is our commitment to achieving the right balance between long-term planning, environmental regulation and the use of market mechanisms to secure the most efficient use of scarce water resources.

7.6 Water companies typically provide their customers with a water supply and remove their wastewater and sewage. This requires sustainable water resources and water treatment facilities as well as sewerage treatment and disposal facilities. It also requires a network to transport the water and wastewater. All of these activities are known generally as ‘upstream services’. However, only certain upstream services will be open to competition. There is no intention, for example, to introduce any contestability into the network. All customers rely on the existence of a resilient network and the Government sees no case for any moves towards the de-averaging of network costs.

Fairness and affordability

7.6 Charges in respect of upstream markets will need to maintain a focus on both the long-term affordability and reliability of services for all customers. The impacts of developing approaches to charging should be assessed to ensure that they prioritise bills that remain good value for all customers current and future.

7.7 Some concerns have been raised in respect of the scope for ‘cherry-picking’ of lower cost to serve customers in the upstream markets leading to a de-averaging of costs. It should be noted that the averaging of charges is common practice in sectors that have much greater scope for contestability than the water sector. There may also be some opportunities for innovation to reduce costs for customers with a higher than average cost to serve – with potential benefits to customers as a whole. Ofwat has a number of tools to limit the effect of de-averaging on customer charges. In developing the wider implementation framework and issuing any future *Charges Rules* in respect of these markets Ofwat will need to carefully consider how best to use these tools in order to ensure that any marginal changes are introduced in a measured fashion and, above all, that they are in the overall interests of consumers as well as specific groups of customers.

Environmental protection

7.7 The efficient use of water resources is fundamental to securing the long-term resilience of water supplies and to protecting the water environment. Charging can play a key role in securing the economically and environmentally efficient use of resources; encouraging innovation and ensuring that environmental goods are costed appropriately.

7.8 In some cases it may be beneficial to introduce targeted price signals to improve recognition of environmental costs – for example encouraging the collection and use of water resources at times of lower demand. However, such tools must be handled carefully to ensure that any change is in the overall interest of customers and the environment. When setting future *Charging Rules* in respect of upstream markets Ofwat must have

regard to their duties to secure the long-term resilience of water undertakers' supply systems and sewerage undertakers' sewerage systems as regards environmental pressures, population growth and changes in consumer behaviour. The regulation of upstream charges must take account of the Government's overall policy objectives for the management of water and waste water and must be well aligned with associated policy tools such as the reform of the abstraction regime and the Water Resources Management Planning process.

Stability and predictability

7.9 The approach to the regulation of charges in the upstream markets should focus on the need to encourage investment in order to build resilience and support growth. Stability and predictability for both customers and investors will be important to support the long-term stability of bills and avoid substantive incidence effects. Companies will continue to be able to recover the costs of efficient investment. The Government's statutory guidance to Ofwat: the Strategic Policy Statement establishes that the regulatory regime must continue to enable efficient, integrated companies to achieve an appropriate return on their assets.

Transparency and customer-focused service

7.10 Charges in the upstream markets should be clear and transparent for all parties. The regulation of charges in this context should focus on the overall benefits to all customers current and future.

Charges for bulk water and secondary supplies

7.11 The Water White Paper set out the Government policy objectives in respect of bulk transfers. The expectation is that transfers will usually be over relatively short distances, with strategic interconnection projects joining up water supply zones within and between company networks and incrementally building a more integrated supply network. Options for interconnection will always need to be assessed objectively alongside alternative approaches in Water Resources Management Plans.

7.12 In setting *Charging Rules* in respect of future bulk supplies Ofwat will need to consider the correct balance of incentives to ensure that the cost of bulk supplies reflects the environmental as well as the economic costs of the trade.

Q6: Do you have any comments on the Government's proposed approach to upstream reform, as described in Chapter 7, and the high level principles set out here?

8. Guidance on charges in relation to developers

8.1 The Water Industry Act 1991 provides for water and sewerage undertakers to charge for new connections to the network, and for associated work. The legislation has been interpreted differently by the undertakers leading to confusion for developers, and can lead to long and costly disputes.

8.2 The Water Act 2014 changes the regime for new connections charges to make it more transparent. The Act includes provisions to remove the complex arrangements for new connections charges and enables Ofwat to set the detail through charging rules. Specifically the Water Act 2014 replaces the power for the undertaker to recover such costs as were reasonably incurred with a power for Ofwat to produce charging rules that the undertakers must follow when setting their connections charges.

8.3 These rules will replace provisions in the WIA relating to various financial requirements that may be imposed by a water undertaker for connections to, and the provision of, water mains, public sewers and some associated infrastructure. The rules may include charges that may be imposed and methods for their calculation, provision for maximum amounts that can be charged, as well as provision as to security that may be required. The rules may also include provisions covering the publication of the charges. The Water Act 2014 also gives Ofwat a power of direction, if Ofwat considers an undertaker is not acting in accordance with the rules.

8.4 These changes will encourage growth by enabling developers to better plan for connections to water and sewerage systems by identifying, quantifying and planning for the costs associated with doing so.

8.5 There are three separate development connections charges:

- The connection charge: this charge is to recover the cost of connecting a property to the existing main or sewer. Undertakers set out standard charges for new connections on a per property basis.
- The infrastructure charge: this charge is to contribute towards the cost of extending the local water distribution network and local sewerage network. The charge is currently set by Ofwat as a flat rate charge on a per property basis across England and Wales. Ofwat have clarified that infrastructure charges are not intended to cover the cost of providing additional capacity at water or wastewater treatment works.
- The requisition charge: this charge is to contribute towards the cost of providing additional water distribution and sewerage infrastructure outside the local network where a developer requisitions infrastructure for a particular development. 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.

Detailed Guidance to Ofwat

8.6 Each of these charges will be covered by Ofwat rules. Government will prepare further detailed guidance to Ofwat on connection charges in accordance with section 144ZD of the Water Act. This will set out the Government's expectations of Ofwat's charging rules in relation to developers, what the rules should cover, calculation of charges and scope of charges. Ofwat must have regard to this detailed guidance in developing its rules. The Ministerial guidance will support the Government's overarching policy objectives.

Fairness and Affordability

8.7 It is right that developers should bear the costs associated with connections to, or adoption of, water and sewerage systems. Charges should ensure that the distribution of costs for new infrastructure between developers and current customers of water and sewerage companies is fair. Cross subsidy between developers and water customers should be limited.

8.8 Charges that are clearly reflective of the work involved will build confidence within the developer community. It will also allow developers to plan and budget for new developments more effectively. Ofwat should set rules that enable water and sewerage companies to recover the costs reasonably incurred in the provision of infrastructure. Where infrastructure is provided that has a greater capacity than needed for a specific new development, the rules should ensure that costs are appropriately apportioned and allocated to the new development.

Environmental Considerations

8.9 We want to ensure a sustainable and resilient water sector. 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.

8.10 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.

Stable and Predictable Charges

8.11 It is important that developers are 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. Where there is a need to adjust charges to make them more cost reflective this should be managed such that it is clear and does not impact on competitiveness.

Transparent and Customer Focused Charging

8.12 Charges should be transparent, simple, predictable, comprehensible and cost reflective. Transparency will reduce uncertainty in the assumptions water and sewerage companies and developers make in planning their business. Ofwat should publish clear principles on the costs that different charges are designed to recover and on the interaction between different elements of a charging scheme, for example the infrastructure charge, requisition charge and the cost of increasing capacity. Ofwat should also set out how the appropriate cost for connection to or adoption of water and sewerage systems will be determined.

8.13 Work has been done, by the industry, to produce a set of standards which outline what developers can expect from water and sewerage undertakers. These standards, combined with the clear charges should improve the customer service developers receive.

Q7: What are your views on the guidance on charges in relation to developers provided in Chapter 8?

9. Conclusion

9.1 This guidance sets out the Government's policy priorities for the water sector. It exercises the power in section 144ZE of the Water Industry Act 1991 and provides the strategic framework to which Ofwat must have regard in developing charging rules for the industry.

9.2 It establishes the foundation for fair and affordable water charges in a stable and predictable system which will benefit customers, companies and investors alike. The aim is to promote a charging regime where bills are set out in a clear, transparent and easily understandable way. In addition, the guidance provides an effective basis for the extension of competition into the water industry from April 2017.

9.3 This guidance also seeks support the protection of the environment through encouraging the efficient use of water and wastewater. It makes an important contribution to realising the Government's objectives of increasing resilience, long term planning and improved customer choice in the water sector, as set out in the Water White Paper in 2011.

Q8: Do you have any other comments about the policy objectives for water and sewerage charging set out in the Charging Guidance?

Q9: Is there anything else you would like to add to your response?

10. Consultation questions

1. Do you agree that the Government's overarching objectives for charging should be *fairness and affordability, environmental protection, stability and predictability and transparency and customer-focused service*?
2. Are there any other comments that you would like to make about the Government's overarching objectives for water and sewerage charging set out in Chapter 2?
3. Do you agree with the Government's policy priorities for charges schemes for household customers outlined in Chapter 4?
4. What are your views on the guidance on charges schemes for non-household customers provided in Chapter 5?
5. Do you think the guidance on charges in relation to the retail market in Chapter 6 will be appropriate for regulating retail charges when the new retail market for non-household customers opens in April 2017? If not, how could it be improved?
6. Do you have any comments on the Government's proposed approach to upstream reform, described in Chapter 7, and the high level principles set out here?
7. What are your views on the guidance on charges in relation to developers provided in Chapter 8?
8. Do you have any other comments about the policy objectives for water and sewerage charging set out in the Charging Guidance?
9. Is there anything else you would like to add to your response?

ii. Next Steps

ii.i The Government has committed to publishing this guidance in preparation for the 16/17 charging year. This will provide clarity around the new framework for water industry charging ahead of the opening of the non-household retail market in April 2017. The guidance kept under review while the Government's reforms to achieve competition in the retail and upstream parts of the market, as set out in the Water Act 2014, are implemented and may be amended as necessary. However, the core principles of fairness and affordability, protection for the environment, stability and predictability, transparency; and customer-focused service which underpin this guidance are expected to stand the test of time.

ii.ii This consultation will run from 9th July 2015 to 6th August 2015 for a total of 4 weeks. The Government will subsequently consider the feedback received and publish a summary of responses in September 2015. The guidance will then be revised and laid in Parliament. Subject to this Parliamentary scrutiny, the guidance will then be published on the GOV.UK website in late November/ early December 2015.

ii.iii Ofwat will subsequently develop new charging rules for the industry based upon the principles set out in the Government's charging guidance.

How to respond

ii.iv This consultation will be open from 9th July 2015 to 6th August 2015. You can respond online at <https://consult.defra.gov.uk>. You can also respond via email to: chargingguidanceteam@defra.gsi.gov.uk. The postal address for responses is: Water Reform team, Area 3B, 17 Smith Square, London SW1P 3JR. Please make sure your responses reach us by 6th August 2015.

Annex A

Category	Charged By	Charged To	Form of Regulation ⁸	1991 Water Industry Act Section Reference(s)
1. Charges to End Users of Water and Wastewater Services				
Standard tariffs for water and wastewater services to households	Undertakers by means of a Charges Scheme	Household customers	Undertakers will be required to ensure that Charges Schemes are in accordance with rules to be produced by Ofwat. In addition, prices are subject to conditions B and E of undertakers' appointments.	142, 143, 143A, 143B, 143C, 143D, 143E, 144A and 144B
Standard tariffs for water and wastewater services to non-households	Undertakers by means of a Charges Scheme	Non-household customers	Undertakers will be required to ensure that Charges Schemes are in accordance with rules to be produced by Ofwat. In addition, prices are subject to conditions B and E of undertakers' appointments.	142, 143, 143A, 143B, 143C, 143D and 143E
So-called "special agreements" between undertakers and non-household customers	Undertakers	Non-households	Undertakers will be required to submit details of agreements to Ofwat so that they can be published on a register. Disputes as to price may be referred to Ofwat for determination under section 56. Prices agreed are subject to condition E of undertakers' appointments.	56 and 142
Prices agreed between water supply licensees and non-household customers	Water supply licensees	Non-household customers	Ofwat has various powers as overseer of the new retail market, e.g. it can insert requirements relating to pricing in licences themselves. Prices to customers of "acquiring licensees" following exit from the retail market by an undertaker will be governed by the terms of "deemed contracts".	17G, 17A, 17HA, 17I, 17J, 17K, 17L, 17M, 17N, 17O, 17P, 17Q and 17R
Resale of water	Customers of undertakers	Final users	Ofwat can make an order in relation to prices charges by customers of undertakers to end-users.	150

⁸ NB: in addition, pricing conduct is generally subject to the provisions of the 1998 Competition Act.

2. Trading Between Service Providers				
Bulk (water) supply prices	Undertaker	Undertaker	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	40E, 40F, 40G, 40 H, and 40 I
Prices charged under an agreement for a main connection into a sewer – a “bulk discharge agreement”	Undertaker	Undertaker	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	110F, 110G, 110H, 110I and 110J
Prices charged by a third party in relation to water supplied to an undertaker	Owner of a water source (e.g. farmer, factory)	Undertaker	To be determined by regulations prepared by the Secretary of State	66M, 66N, 66O and 66P
Wholesale charges for water supply and common carriage prices in relation to the transportation and/or treatment of water services	Undertaker	Licensee	Undertakers and licensees will enter into agreements which will cover pricing matters. However, undertakers will be required to ensure that prices are in accordance with codes produced by Ofwat. Disputes may be determined by Ofwat.	66D, 66E, 66EA, 66EB, 66EC, and 66ED
Wholesale charges for wastewater services and common carriage prices in relation to the transportation and/or treatment of wastewater services	Undertaker	Licensee	Undertakers and licensees will enter into agreements which will cover pricing matters. However, undertakers will be required to ensure that prices are in accordance with codes produced by Ofwat. Disputes may be determined by Ofwat.	117E, 117I, 117J, 117K, 117L and 117M
3. Charges for New Development and Miscellaneous Works				
Charges in connection with a notice of a water main requisition	Undertaker	Developer	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	41, 42, 144ZA, 144ZB, 144ZC, and 144 ZD.
Charges for the making of a connection with a water main	Undertaker	Developer (or household)	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	45, 144ZA, 144ZB, 144ZC, and 144 ZD.
Charges for ancillary works relating to the making of a connection with a water main	Undertaker	Developer (or household)	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	46, 144ZA, 144ZB, 144ZC, and 144 ZD.
Charges contained in agreements relating to the adoption of a water main or service pipe (“self-lay”)	Undertaker	Developer	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	51A, 51C, 51CD, 51CE, 51CF, and 51CG.

Charges in connection with a notice of a sewer requisition	Undertaker	Developer	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	98, 99, 144ZA, 144ZB, 144ZC, and 144 ZD.
Charges in connection with the provision of lateral drains	Undertaker	Developer (or household)	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	101B, 144ZA, 144ZB, 144ZC, and 144 ZD
Charges for the making of a connection with a public sewer	Undertaker	Developer (or household)	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	107, 144ZA, 144ZB, 144ZC, and 144 ZD
Charges contained in agreements relating to the adoption of a sewers, etc. ("self-lay")	Undertaker	Developer	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat	104, 105ZF, 105ZG, and 105ZI
Infrastructure charges	Undertaker	Developer, household, or non-household customer	Undertakers will be required to comply with condition C of their appointment.	146
Charges for moving infrastructure and apparatus	Undertaker	Any person with an interest in land where assets are situated (or in land adjacent).	Undertakers will be required to ensure that prices are in accordance with rules which may be produced by Ofwat.	185, 144ZA, 144ZB, 144ZC, and 144 ZD