



**Consultation:**

**Developer Services Charging  
Arrangements & NAVs Bulk Supply  
Charges for 2021/22**

**November 2020**

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## **1. Introduction**

Welcome to our consultation on the 2021/22 charges for New Connection Services and Bulk Supply Charges for NAVs. This consultation provides more information on our charging arrangements and the changes we envisage making. It is an opportunity for you to share your views on what we are proposing as well as to provide feedback on how we can improve your customer experience.

The rest of this Introduction explains the context to our consultation and the process that we will follow. Part A of the consultation then covers charges for New Connection Services and Part B of the consultation covers Bulk Supply Charges for NAVs.

### **1.1. Why is charging an important topic?**

Over the course of 2019 and 2020, Ofwat has put more emphasis on the importance of effective markets, with a particular focus on the Business Retail and Developer Services markets. Effective markets can deliver a number of benefits for customers, society and the environment. This can take the form of innovative approaches to products and services offered, improved company performance, increased number of market players resulting in customers having greater choice, improved quality of service and more competitive prices.

The charges that we make for new connections and for bulk supply to NAVs are an important determinant of the ability of service providers to compete effectively in these markets.

### **1.2. Why are we consulting on our charges?**

We are committed to engaging with our customers on an ongoing basis. We know that last year our charging arrangements consultation exercise fell short: we did not communicate clearly enough or allow enough time for you to provide us with the feedback we wanted.

As a result of the feedback we have received we are now more committed than ever to engage with our customers and help promote effective markets. This consultation is a first step towards achieving a more transparent and inclusive way of receiving your feedback and capturing it in our work.

Our regulator, Ofwat, has also recently carried out a review of incumbent company support for effective markets<sup>1</sup>. The findings of this review, including examples of best practice, give us a further opportunity to improve our efforts in a way that goes beyond compliance. We would welcome feedback on elements of this review that you consider particularly important for us to take into account.

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<sup>1</sup> <https://www.ofwat.gov.uk/regulated-companies/markets/review-of-incumbent-company-support-for-effective-markets/>

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In March 2020 we published our first Bulk Supply Charges for NAVs. Although these charges were developed based on Ofwat's applicable guidance, we believe our approach can be refined to incorporate elements of best practice as highlighted in Ofwat's recent review.

We intend to follow up on this consultation with clear communication of our proposed charges and periodic engagement with customers.

### 1.3. What are the rules governing charging arrangements?

We must follow two sets of rules in setting our charges:

- Ofwat's 'Charging Rules for New Connection Services (English Undertakers)'
- Charges Scheme Rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991

We must also follow [IN 20/07](#) – Expectations, assurance and information requirements for water company charges for 2021-22.

In order to comply with these rules, we must uphold the following principles in our charging arrangements:



We are also required to carry out proportionate, timely and effective consultation with groups likely to be significantly affected by any changes to our charges and charging arrangements.

### 1.4. Who is this document aimed at?

Our charging arrangements directly affect the following groups:

- Homeowners and Housebuilders;
- Developers;
- Self-Lay Providers (SLPs); and
- New Appointees (NAV).

In accordance with the Charges Scheme Rules we invite views from the Consumer Council for Water. We also welcome input and feedback from all interested stakeholders.

## 1.5. What are we consulting on?

Last year, we implemented changes to our Charging Arrangements in line with Ofwat's Charging Rules for New Connection Services (English Undertakers) that came into effect on 1 April 2020. Whilst there are no changes to the Charging Rules requiring us to make significant methodological changes to the way we calculate our charges this year, we acknowledge that additional work is required to address the feedback we have received both from our customers and from Ofwat and to incorporate elements of 'best practice' in our work.

The purpose of this consultation is to seek feedback that will help to shape updates to our [Charging Arrangements for New Connection Services](#) and [Bulk Supply Charges for NAVs](#).

**Part A** of the consultation concerns New Connection Services. We invite feedback on:

- How our charges are calculated (Section 2);
- How our charges are presented (Section 3); and
- Our proposed transitional arrangements (Section 4).

**Part B** of the consultation concerns Bulk Supply Charges for NAVs. We invite feedback on:

- Calculating avoided costs (Section 5);
- Driving environmental improvements (Section 6); and
- Improving our Bulk Supply Charges document (Section 7).

The feedback received on this consultation will help us inform the way we present and calculate our charges for 2021/22.

We are in the process of calculating our charges for 2021/22 and currently we do not anticipate large variations in our charges for typical developments compared to 2020/21. However, if the charges are materially different compared to last year, we will engage with customers before the publication of our final charges on 31 January 2021.

As part of Ofwat's information requirement, we will also publish a statement of significant changes for new connections and developments stating whether bills for typical developments have increased by more than 10% and what handling strategies we have developed to manage the impact (if any) alongside publishing our final 2021/22 charges.

## 1.6. Have your say

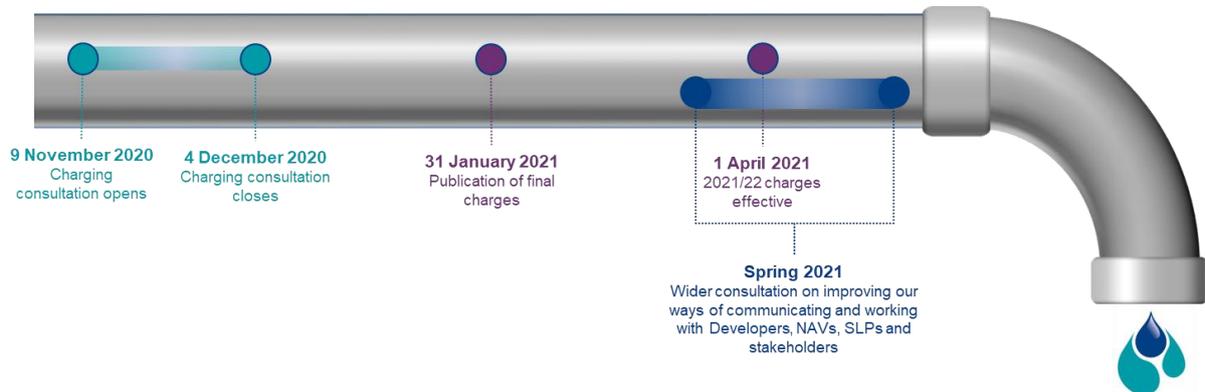
You are kindly invited to provide feedback on the questions set out throughout this document and by using the online survey (link to follow) by 17:00 on Friday 4 December 2020. You can also send your response directly to us at [developerservices@seswater.co.uk](mailto:developerservices@seswater.co.uk). Please feel free to respond to as many or as few questions as appropriate.

We will publish our final charges for new connections services and bulk supply charges by 31 January 2021 and they will come into effect from 1 April 2021.

This consultation is part of a wider programme of engagement and communication with stakeholders. In Spring 2021, we will publish another consultation covering a wider set of topics on how we can work with you more effectively.

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Figure 1.1: Our engagement programme



## Privacy notice

Your response to this consultation will help us shape our Charging Arrangements for New Connections Services and Bulk Supply Charges for NAVs and understand stakeholder views and preferences. Your response will be securely stored for up to one year and only used in the context of this consultation, after which it will be securely disposed of. By participating in this consultation, you agree to us using your response in our results. We will not publish names of individuals or organisations but may refer to the type of stakeholder.

For more information about our privacy policy please visit: <https://seswater.co.uk/about-us/policies/privacy-notice>.

# Part A – Charging Arrangements for New Connection Services

## 2. Calculating our charges

Our 2020/21 Charging Arrangements are organised by categories of charges. The main ones are:

- Application charge;
- Infrastructure charge;
- Income offset;
- Connections charges;
- New water mains;
- Additional charges;

For our 2021/22 Charging Arrangements, we propose to expand on the description of our charges and how they are set to increase transparency and clarity of our Charging Arrangements. Additionally, we propose to make targeted changes to the application charge and how we charge for traffic management and would like your feedback on our approach to setting the infrastructure charge and the income offset. We discuss these items in turn below.

### 2.1. Application charge

#### Our existing approach

An application fee is charged to a Developer for the cost of processing an application for new connection services. This includes recording the application into our system, getting in touch with the Developer to clarify any application details required in the early stages of the process as well as processing the application in our accounting system and designing the requested Development. Our Charging Arrangements also refer to the possibility of offering a discounted fee if a customer employs its own designer.

Additionally, as part of our Application charge section, we set out the charges for re-quote fees and phased connection works.

#### Our proposed approach for 2021/22

To increase transparency and support effective markets, we propose to make the following changes:

*Table 2.1: Proposed changes to application charge*

Proposed change	Expected benefits of our proposed approach
1. Rename our section to 'Ancillary charges'.	<ul style="list-style-type: none"> <li>• To reflect that it captures more than the application charge.</li> </ul>

Proposed change	Expected benefits of our proposed approach
2. Provide a clear description of each charge and in what context it applies.	<ul style="list-style-type: none"> <li>• Providing additional context on our charges and under what circumstances they apply and what each charge covers will make our charges more transparent and predictable for our customers.</li> </ul>
3. Split out the mains design element from the application fee.	<ul style="list-style-type: none"> <li>• The design of a Development is a contestable element and either SESW or an alternative provider (SLP) can undertake this for a Developer.</li> <li>• Splitting out the design element from the application fee – a non-contestable element – will allow an equally efficient SLP to compete for the Development.</li> </ul>
4. Include a charge for reviewing a design.	<ul style="list-style-type: none"> <li>• The review of a design is a non-contestable element given SESW will ultimately adopt the assets built by an SLP.</li> <li>• An SLP should be able to know upfront the charge for SESW to review its design – this will encourage competition in the market.</li> </ul>

## Questions

1. Do you agree with the proposed changes to the application charge, as described in Table 2.1?
  - Strongly agree
  - Agree
  - Disagree
  - Strongly Disagree

Please elaborate on your response.

## 2.2. Charging for traffic management as part of our charges

### Our existing approach

To provide you with New Connection Services, we usually need to work in a footpath, road or carriageway. Consequently, traffic management is required for us to undertake the work safely and efficiently with as minimal disruption as possible to roads users.

All traffic management outside of the development site is subject to planning and co-ordination with the local highways authority in accordance with the New Roads and Streetworks Act 1991, as amended by the Traffic Management Act 2004.

We operate within eight local highway authorities and each authority has its own set of traffic management charges. As such, our existing approach consists of the following:

- Our Charging Arrangements refer to our Charging Arrangements Calculator to get an estimate of traffic management charges depending on the parameters and requirements of a customer's Development.

- Once the customer lodges its application into our system, we calculate the exact traffic management charges based on the detailed information supplied by the customer based on its Development.

Our existing Charging Arrangements also provide a breakdown of indicative traffic management charges and note that works may be subject to additional highway authority charges and that they can be subject to change at any time. We have replicated the table from our Charging Arrangements below.

*Table 2.2: SESW traffic management charges 2020/21 (Figure 8.2d in Charging Arrangements)*

Traffic management charges	2020/21 charges (£)
Full road closure	2,500.00
Bus stop suspension	250.00
Traffic light suspension	483.50
Pedestrian crossing suspension	373.83
Parking bay suspension	70.00
Permit charge (varies on region/road) per request for access	65.00
Three way traffic lights (per week)	502.34
Four way traffic lights (per week)	561.41
Charge for manual operation (per day)	218.59
Set out $\frac{3}{4}$ way lights	247.01

We acknowledge that our existing approach has some advantages and disadvantages.

On the one hand, our existing approach is cost-reflective: as part of providing a detailed quote to our customer, we calculate the traffic management charges we anticipate to incur to complete the works. We note that we do not make any upward/downward adjustments to reflect actual costs incurred by us ex-post.

On the other hand, our existing approach does not necessarily allow for customers to work out their traffic management charges as they would not necessarily know what would be needed for their Development without requesting a quote. This makes our charges less predictable.

Other incumbent water companies use different approaches to charge for traffic management and that there is no concerted approach across the industry. For instance, some companies apply an uplift on their charges to recover the overall cost that they would incur – this approach is in accordance with the principles of stability and predictability but could be perceived as lacking transparency and cost-reflectivity. Other incumbent companies have fixed charges upfront – this approach is in accordance with the principle of transparency but could be perceived as lacking predictability as the customer would not necessarily know what traffic management measures their Development could require. Finally, we are aware that at least one incumbent is considering charging for traffic management at cost upon receipt of

information from local highway authorities – this approach shares some similarities with our existing approach.

## Our proposed approach for 2021/22

As part of our review of the structure of our charges, we are considering merging some of our charges where it would be difficult for the customer to know what charges would be required. Traffic management measures fall in that category.

We are considering uplifting our service connections, mains requisitions or diversion charges to include some of the costs associated with traffic management. The table below describes the traffic management charges that would be charged separately and those that would be included in our service charges as an uplift.

*Table 2.3: SESW traffic management charges 2021/22 – proposed changes*

Traffic management charges	Proposed change
Full road closure	Separate charge
Bus stop suspension	Uplift on charges
Traffic light suspension	Uplift on charges
Pedestrian crossing suspension	Uplift on charges
Parking bay suspension	Uplift on charges
Permit charge (varies on region/road) per request for access	Uplift on charges
Three way traffic lights (per week)	Separate charge
Four way traffic lights (per week)	Separate charge
Charge for manual operation (per day)	Uplift on charges
Set out ¾ way lights	Separate charge
Lane rental	Separate charge

### Expected benefits of our proposed approach for 2021/22:

- Stable and predictable service connection, mains requisitions and diversion charges that include the costs associated with traffic management requirements.
- Customers can confidently work out how much a Development may cost.

## Questions

2. Do you agree with the proposed changes to traffic management charges, as described in Table 2.3?
  - Strongly agree
  - Agree
  - Disagree

- Strongly Disagree

Please elaborate on your response.

## 2.3. Infrastructure charge

### Our existing approach

An infrastructure charge is payable when a property is connected to the water network for the first time. The charge is a contribution to the additional cost of providing the infrastructure of pipes, pumping stations and treatment works necessary for the provision of water services as a consequence of new developments.

Our infrastructure charge is calculated by:

- (a) Taking the average of the spend on water network reinforcement associated with new water mains or connections over a five-year rolling period.
- (b) Taking the average of the estimated number of new connections over a five-year rolling period.
- Dividing (a) the average spend on water network reinforcement by (b) the number of expected new connections.

Each year we reflect on and review our actual outturn cost of investment and infrastructure income to make any adjustments to our forecast expenditure and infrastructure charge calculation. This ensures that current and future expenditure on to the network to cover the demand for new development and growth is reflected fairly and transparently to all customers.

We apply a single level of infrastructure charge across our supply area, i.e. a flat rate, as we plan our water supplies as a single water resource zone and have the ability to supply much of the area from more than one treatment works. Our 2020/21 infrastructure charge is presented in the table below.

2020/21 infrastructure charge	Charge per property connected
Water	£369

We also offer a discount on the infrastructure charge for properties built to a higher standard of water efficiency than required by building regulations. Our current discounts are:

- A 15% reduction on the fixed price listed above if all bathroom fittings are 'A'-rated based on the water label OR rainwater harvesting or greywater recycling is fitted. This equates to a water usage of around 105 litres/person/day.
- A 30% reduction if all bathroom fittings are 'A'-rated based on the water label AND either rainwater harvesting or greywater recycling is fitted. This equates to a water usage of around 80 litres/person/day.

We also offer reduced charges for redeveloped sites where a Developer can provide evidence that a Development has been using the water network within the last five years. For instance, if a new Development of 20 properties is built on a site that previously had five properties and

were connected to the network in the last five years, the infrastructure charge will be reduced to apply to 15 properties.

A customer has two payment options for infrastructure charges:

- A customer can pay for the infrastructure charge upfront, at the same time as paying for the rest of the quote.
- A customer can pay for the infrastructure charge in arrears, upon completion of the works.

In either case, the customer pays for the infrastructure charge as quoted, regardless of when the works are completed and whether the infrastructure charge has changed.

### **Our proposed approach for 2021/22**

Although we have considered zonal charging for the infrastructure charge, at this time we do not have evidence it would be appropriate for our community, though this is an issue that we will continue to review periodically. This is because:

- SES covers a small geographical area and the network reinforcement requirements are similar across all areas meaning the differences would be minimal; and
- we have the ability to supply much of the supply area from more than one treatment works.

For the 2021/22 Charging Year, we:

- propose to maintain our existing approach with a single level of infrastructure charge across our supply area;
- propose to maintain our existing discounts for water efficient properties;
- propose to maintain our approach to applying reduced charges for redeveloped sites; and
- do not propose to make any changes to the payment options for infrastructure charges in 2021. However, we are considering making changes for 2022/2023 Charging Year:

A customer would still have two payment options for infrastructure charges:

- A customer could pay for the infrastructure charge upfront, at the same time as paying for the rest of the quote; this would be at the infrastructure charge prevailing at the time of payment.
  - A customer could decide to pay for the infrastructure charge in arrears, upon completion of the works but it would be charged at the infrastructure charge prevailing at the time of payment as opposed to the infrastructure charge prevailing at the time the initial quote was provided.
-

## Questions

3. We are proposing to maintain a flat rate for infrastructure charges rather than zonal. To what extent do you agree or disagree with this proposal?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

4. We are proposing to continue offering the same discount for water efficient properties and reduced charges for redeveloped sites. To what extent do you agree or disagree with this proposal? Do you have a suggestion of other ways of promoting water efficiency?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

5. For 2022/23, i.e. in two years' time, we propose to maintain the option to pay for the infrastructure charge in advance or upon connection but are considering applying the infrastructure charge prevailing at the time of payment.

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

## 2.4. Income offset

### Our existing approach

SESW subsidises the cost of new connections/water mains based on the amount of new revenue it expects to receive from the new properties connected over the next twelve years. This contribution made by us to developers or SLPs is called the 'income offset', and it is deducted from the infrastructure charge. The contribution is shared across all new connections in the form of a discount, regardless of the type of development, i.e. we apply a flat income offset.

We use the Discounted Aggregate Deficit (DAD) approach to calculate the income offset which recovers costs partially from new customers and partially from existing bill payers. We model

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the potential development mains work for a Charging Year and run the total cost of mains and services through the DAD calculator to establish the monies to be recovered upfront from the new customers and the monies to be recovered from existing bill payers over a period of twelve years (including the cost of borrowing).

### **Our proposed approach for 2021/22**

At this stage, we are not minded to make any changes to the way we calculate the income offset but are looking at further options and are open to stakeholder suggestions.

### **Questions**

6. We currently calculate the income offset using the DAD approach. Do you agree with this approach? If not, please provide alternative suggestions for the calculation of the income offset.

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

### **2.5. Other comments**

7. Do you agree with our areas of focus? Do you have further suggestions you wish to make that are not captured by any of the preceding questions?
-

### 3. Presenting our charges

#### Our existing approach

We have received some constructive feedback in the past year on ways to improve how we present our Charging Arrangements. We understand that some of our customers find it challenging to work out how much their Development would cost due to:

- the way we present our charges;
- how we refer the customer to our Charging Arrangements Calculator tool for guidance on how our charges are set instead of providing a clear description with the Charging Arrangements themselves;
- the technical language we use throughout the document making our charges less accessible to all; and
- the limited number of clear worked examples provided in our Charging Arrangements.

#### Our proposed approach for 2021/22

For the 2021/22 Charging Year, we are committed to making significant changes to the way we present our charges to:

- provide a more customer-focused service;
- increase predictability and transparency of our charges; and
- improve customer experience when using the document.

To achieve this, we have thought of different ways we can improve the usability, look and feel of our Charging Arrangements for 2021/22 and have taken on board feedback received. In addition to complying with Ofwat's IN 20/07 specific information requirements (including worked examples), we propose to make the following changes:

*Table 3.1: Proposed changes to the presentation of our charges*

Proposed change	Rationale for change and expected benefits of our proposed approach
<ul style="list-style-type: none"> <li>• Present all of our charges exclusive of VAT.</li> </ul>	<ul style="list-style-type: none"> <li>• For clarity and consistency with other incumbent water companies.</li> </ul>
<ul style="list-style-type: none"> <li>• Remove decimal places and round to the nearest £5.</li> </ul>	<ul style="list-style-type: none"> <li>• For simplicity.</li> </ul>
<ul style="list-style-type: none"> <li>• Present all of our charges in tabular form.</li> </ul>	<ul style="list-style-type: none"> <li>• We currently use a mix of tabular and text/paragraph to present our charges. The consistent use of tables throughout the document should make it easier for customers to find the charges relevant to their Development.</li> <li>• To ensure all of our charges can be found in a single document</li> </ul>
<ul style="list-style-type: none"> <li>• Clearly label the charges that are contestable and non-contestable.</li> </ul>	<ul style="list-style-type: none"> <li>• Complies with Rule 15 of the Charging Rules.</li> </ul>

Proposed change	Rationale for change and expected benefits of our proposed approach
	<ul style="list-style-type: none"> <li>Allows customers to understand what elements of their Development can only be completed by SESW versus an SLP.</li> </ul>
<ul style="list-style-type: none"> <li>Introduce a section in the document for self-lay charges.</li> </ul>	<ul style="list-style-type: none"> <li>Allows SLPs to quickly identify what charges are relevant to them instead of having to read the entire document.</li> </ul>
<ul style="list-style-type: none"> <li>Provide a breakdown of the underlying calculations in the worked examples.</li> </ul>	<ul style="list-style-type: none"> <li>Providing the underlying calculations in the worked examples will increase transparency and clarity.</li> </ul>
<ul style="list-style-type: none"> <li>Simplify the language we use to describe our charges and make use of Ofwat's glossary of terms.</li> </ul>	<ul style="list-style-type: none"> <li>Increase consistency across the industry and facilitate understanding of charges for developers working in multiple regions and dealing with multiple incumbents.</li> </ul>
<ul style="list-style-type: none"> <li>Explain what our charges are and in what context they apply and when special circumstances exist.</li> </ul>	<ul style="list-style-type: none"> <li>Providing additional context on our charges and under what circumstances they apply and what each charge covers will make our charges more transparent and predictable for our customers.</li> <li>Understanding where special circumstances exist and therefore fixed charges do not apply.</li> </ul>

## Questions

8. Do you agree with the proposed changes to the presentation of our charges as described in Table 3.1?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please explain your score.

9. Would you find any specific additional worked examples to be helpful? Please elaborate on your response.

10. What other suggestions do you have for improving the presentation / layout of the Charging Arrangements?

## 4. Our proposed transition arrangements

Our new Charging Arrangements will be published on 31 January 2021 and will come into effect on 1 April 2021.

All applications received before 1 April 2021 will be subject to our 2020/21 Charging Arrangements. However, after 1 April 2021, if a customer has not accepted and paid for a previous quote<sup>2</sup> and feel they would be better off under the new Charging Arrangements they can request a requote (subject to a requote fee). Once the new quote is produced based on the 2021/22 Charging Arrangements, the customer has the choice to accept and proceed under the initial quote or the new quote.

All quotes issued after 1 April 2021 will be subject to our 2021/22 Charging Arrangements.

### Questions

11. To what extent do you agree or disagree with our transition arrangements proposal?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

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<sup>2</sup> Quotes are valid for three months from the date they are issued

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# Part B – Bulk Supply Charges for NAVs

## 5. Calculating avoided costs

### Our existing approach

We calculate our bulk charges using the “wholesale minus” approach as introduced in Ofwat’s 2018 guidance. This approach takes our average wholesale charges as a starting point and deducts onsite costs that we would avoid (referred to as avoided costs) if a NAV were to provide the “last mile” service. The residual is our bulk supply charges.

We calculate our avoided costs using a “middle-down” approach where we combine company-level data from the annual performance reports with more granular information on categories of operating costs to derive unit costs for the last-mile infrastructure. We use historical data on operating costs across different categories to estimate the share of total treated water distribution operating expenditure that can be avoided if NAVs were to provide “last mile” service. We then apply this share to forecast treated water distribution operating expenditure as reported in Ofwat’s Annual Performance Report (APR) to estimate avoided costs in 2020/21. To obtain an “avoided cost per connection” figure (i.e. £/connection) we divide avoided costs by the length of mains and multiply the resulting £/meter figure by the meters of mains per housing developing connections.

2020/21 charges	Charge per connection
Avoided costs per connection	£20.08

Under this approach, on-site avoided costs relate to direct operating expenditure (i.e. operational costs that can be associated to a specific on-site activity) and capture an element of indirect costs (i.e. general and support costs) due to the starting point being the APR costs.

### Our proposed approach for 2021/22

Ofwat’s 2018 [guidance](#) does not prescribe a way of deducting the ongoing costs of operating and maintaining on-site assets from the relevant wholesale tariffs.

The [CEPA 2020 report on NAV Bulk Supply Charges](#) (commissioned by Ofwat) considered there is no single preferred approach for calculating avoided costs. Bottom-up approaches – which use specific estimates of typical costs incurred for different activities identified as avoided – can be more cost-reflective but can also be less transparent than more top-down or middle-down approaches – which use company-level data for different activities identified as avoided and allocating them to the on-site network.

In its recent [consultation on NAV Bulk Supply Charges](#), Ofwat discussed the trade-offs between the different approaches in relation to the charging principles of consistency, transparency, simplicity, and cost-reflectivity and concluded that it is minded to prefer bottom-

up approaches when estimating avoided costs but said that an alternative approach would be to apply middle-down approaches given they would be more transparent than top-down approaches as would provide more granular cost segmentation than solely relying on the annual performance reports .

Based on the above, we are proposing to retain the use of a middle-down approach and to enhance the transparency with regards to how we calculate our avoided costs for 2020/21 by explaining our approach in more detail.

Both the CEPA report and the Ofwat consultation discussed the potential inclusion of additional categories of avoided costs which should not be limited to direct operating expenditure only. For instance, where a NAV operates the last mile infrastructure, it is expected that the incumbent could incur lower capital maintenance expenditure and/or avoid certain additional indirect (e.g. overhead) costs. We are therefore considering whether to widen our definition of avoided costs by capturing those additional cost categories.

Due to the recent change in the income offset rule, the depreciation and returns on assets element of the wholesale minus approach are no longer applicable. The CEPA report puts forward a number of different options for providing a suitable rate of return for NAVs to compensate for this change. We are therefore considering the option of a margin approach, akin to the approach taken in the water retail market.

The table below presents a breakdown of the avoided costs captured in our current approach and our new proposed approach.

*Table 5.1: SESW avoided costs: current and proposed approach*

Avoided costs captured in our current approach for 2020/21 Bulk Supply charges	Potential avoided costs to be captured in our proposed approach for 2021/22 Bulk Supply charges
<ul style="list-style-type: none"> <li>• Direct &amp; indirect operating costs</li> </ul>	<ul style="list-style-type: none"> <li>• Direct operating costs</li> </ul>
<ul style="list-style-type: none"> <li>• Leakage</li> </ul>	<ul style="list-style-type: none"> <li>• Indirect operating costs</li> </ul>
	<ul style="list-style-type: none"> <li>• Leakage</li> </ul>
	<ul style="list-style-type: none"> <li>• Indirect costs</li> </ul>
	<ul style="list-style-type: none"> <li>• Capital maintenance costs</li> </ul>
	<ul style="list-style-type: none"> <li>• Margin (to replace the rate of return element)</li> </ul>

**Expected benefits of our proposed approach for 2021/22:**

- Higher cost reflectivity through a bottom-up approach;
- More cost-reflective bulk supply charges through expansion of set of avoided on site costs;
- Alignment of our approach with Ofwat’s preferred minded to position;

## Questions

12. To what extent do you agree or disagree with our proposal to retain the use of a middle-down approach and to enhance the transparency with regards to how we calculate avoided costs by explaining our approach in more detail?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

13. To what extent do you agree or disagree with our proposal to expand the set of avoided costs captured in our approach?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

14. To what extent do you agree or disagree with our proposal to introduce a margin approach to compensate for the change in the income offset rule?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

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## 6. Driving environmental improvements

The Ofwat 2018 guidance did not explicitly address the question of environmental improvements/impacts on bulk charges for NAVs. In its latest (2020) consultation, Ofwat asked stakeholders whether it should be more prescriptive on the role water companies should have to foster environmental improvements.

One way we can contribute to environmental improvements is through the way we capture leakage allowances in our bulk charges.

### Our existing approach

Bulk supply charges are reduced to account for leakage between the boundary of the NAV site to the premises on site. As such, if we assume that leakage is set at an appropriate level, charges will be lower as a result of reducing metered volumes to account for the right level of leakage. However, if the leakage allowance is set too high, a NAV may benefit from lower charges despite a high level of leakage. The magnitude of this risks depends on the degree of control that NAVs have on leakage levels.

Our current approach on leakage relies on the average actual level of leakage from the current NAV Water Resource Management Plans. By relying on NAVs own leakage level, we ensure highest reflectivity of our charge to the condition of a newly developed site.

### Our proposed approach for 2021/22

For 2021/22 we are considering some variations in the way we capture leakage in our bulk supply charges. We are considering the use of a wider set of benchmarks for leakage levels of comparable sites. For example, actual level of leakage from i) the current NAV Water Resource Management Plans, ii) our own sites of similar size; and iii) average expected leakage of a hypothetical new development of similar size based on technical studies. We would then pick the minimum leakage level from our benchmark.

We believe this approach is more likely to capture an “efficient” level of leakage thus only lowering the bulk supply charges by an “efficient” amount. This in turn, would incentivise a NAV to reduce its leakage levels. In this way, we will reach a balance between cost reflectivity and efficiency, whilst minimising environmental impacts.

#### Expected benefits of our proposed approach for 2021/22:

- Incentivises lower leakage levels;
- Improved balance between cost-reflectivity and efficiency.

## Questions

15. To what extent do you agree or disagree with our proposal to use a wider benchmark for leakage?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

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## 7. Improving our Bulk Supply Charges document

We are committed to taking your feedback on board to improve the look and feel of our bulk supply charges document.

16. We therefore invite you to provide feedback on how we can improve our document. In your response you may wish to consider the following:

- What are your views on the existing bulk supply charges document?
  - Would additional worked examples be useful to capture the complexity of different NAV sites, e.g. example for a non-standard NAV?
  - What other suggestions do you have for improving the bulk supply charges?
-

## Appendix

### Summary of consultation questions

1. Do you agree with the proposed changes to the application charge, as described in Table 2.1?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

2. Do you agree with the proposed changes to traffic management charges, as described in Table 2.3?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

3. We are proposing to maintain a flat rate for infrastructure charges rather than zonal. To what extent do you agree or disagree with this proposal?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

4. We are proposing to continue offering the same discount for water efficient properties and reduced charges for redeveloped sites. To what extent do you agree or disagree with this proposal? Do you have a suggestion of other ways of promoting water efficiency?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

5. For 2022/23, i.e. in two years' time, we propose to maintain the option to pay for the infrastructure charge in advance or upon connection but are considering applying the infrastructure charge prevailing at the time of payment.

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

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6. We currently calculate the income offset using the DAD approach. Do you agree with this approach? If not, please provide alternative suggestions for the calculation of the income offset.

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

7. Do you agree with our areas of focus? Do you have further suggestions you wish to make that are not captured by any of the preceding questions?

8. Do you agree with the proposed changes to the presentation of our charges as described in Table 3.1?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please explain your score.

9. Would you find any specific additional worked examples to be helpful? Please elaborate on your response.

10. What other suggestions do you have for improving the presentation / layout of the Charging Arrangements?

11. To what extent do you agree or disagree with our transition arrangements proposal?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

12. To what extent do you agree or disagree with our proposal to retain the use of a middle-down approach and to enhance the transparency with regards to how we calculate avoided costs by explaining our approach in more detail?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

13. To what extent do you agree or disagree with our proposal to expand the set of avoided costs captured in our approach?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

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14. To what extent do you agree or disagree with our proposal to introduce a margin approach to compensate for the change in the income offset rule?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

15. To what extent do you agree or disagree with our proposal to use a wider benchmark for leakage?

- Strongly agree
- Agree
- Disagree
- Strongly Disagree

Please elaborate on your response.

16. We therefore invite you to provide feedback on how we can improve our document. In your response you may wish to consider the following:

- What are your views on the existing bulk supply charges document?
  - Would additional worked examples be useful to capture the complexity of different NAV sites, e.g. example for a non-standard NAV?
  - What other suggestions do you have for improving the bulk supply charges?
-

## Glossary

Term	Description
Act	The Water Industry Act 1991 as amended from time to time.
Asset payment	The amount described in section 51CD (3) of the Water Industry Act 1991 in relation to a section 51A agreement with a Water Undertaker. This is a payment made to a developer who has selected a Self-Lay Provider to lay its mains and connections to properties. It is the water company's contribution to the mains construction costs.
Carriageway	Tarmac covered ground
Charges Scheme Rules	The Charges Scheme Rules issued by the Water Services Regulation Authority under sections 143(6A) and 143B of the Water Industry Act 1991.
Charging Arrangements	This document which outlines the approach to charging for new connection services, including income offsets and the methodologies for calculating those, applied by us in accordance with the Charging Rules.
Charging Rules	Charging Rules for New Connection Services (English Undertakers) issued under sections 51CD, 105ZF and 144ZA of the Act.
Charging Year	A calendar year running from 1 April in a given year to 31 March in the following year.
Connection charge	A charge for the physical connection to the water main.
Contestable work	Work or services that can be completed by either the relevant undertaker or persons other than the relevant undertaker.
DAD	The discounted aggregate deficit approach used to calculate the Income Offset.
Developer	Any person or business which is responsible for a Development.
Development	Premises on which there are buildings, or on which there will be buildings when proposals made by any person for the erection of any buildings are carried out, and which require connection with, and/or modification of, existing water or sewerage infrastructure.
Diversions	The alteration or removal of a public water main or sewer in accordance with section 185 of the Act only.
Diversion charge	A charge for moving an existing water main.
Domestic premises	Any premises used wholly or partly as a dwelling or intended for such use.
Domestic purposes	As defined in The Water Industry Act 1991.

Term	Description
Existing main	Main that was in operation before development commenced.
Fixed Charges	Charges set for a given Charging Year which are fixed in amount or which are calculated by reference to a predetermined methodology set out in the undertaker's Charging Arrangements, the application of which allows calculation at the outset of the total amount owing in that Charging Year in respect of the charges in question. Such charges are to be fixed for a Charging Year, as defined above.
Footpath (Footway)	A concrete covered surface
House	Any building or part of a building that is occupied as a private dwelling house or which, if unoccupied, is likely to be so occupied and, accordingly, includes a flat.
Income offset	A discounted sum of money offset against the infrastructure charges that would otherwise be applied in recognition of revenue likely to be received by the Water Undertaker in future years for the provision of supplies of water to premises connected to the new water main.
Infrastructure Charge	The charges described in section 146(2) of the Water Industry Act 1991. That is, a charge paid by the developer to the water company when a property is connected to the company's water supply for the first time which contributes to wider network reinforcement to meet the increased demand arising from the new connections.
NAV	New appointment and variations provide water and/or sewerage services to customers in an area previously served by the incumbent monopoly provider. A new appointment is made when Ofwat appoints a company for the first time to provide services for specific geographic area. A variation is where an existing appointment is varied to extend the areas served.
Network reinforcement	Refers to work other than Site Specific Work, as defined below, to provide or modify such other: i. Water Mains and such tanks, service reservoirs and pumping stations, or ii. Sewers and such pumping stations as is necessary in consequence of the Site Specific installation or connection of Water Mains, Service Pipes, Public Sewers and Lateral Drains.
New appointee	Company holding an appointment as a relevant undertaker where the conditions of that appointment limit the charges that can be fixed under a charges scheme by reference to the charges fixed by one or more other relevant undertakers.
New Connection Services	The collective term for New Water Mains, New Sewers, Service Connections, Lateral Drains, Waste Connections and Diversions.

Term	Description
New Water Mains	A water main provided by us in accordance with our duties under section 41(1) of the Act.
No excavation	These charges apply where we do not undertake any excavation, backfilling or reinstatement, for example, where the trench has been pre-excavated by you to our standards.
Non-Contestable Work	Work or services that only the relevant undertaker (or an agent acting on their behalf) can do or provide..
Non-domestic purposes	For a service connection or new water main: a. the premises being connected to the water network do not consist in the whole or any part of a building; or b. the supply is for purposes other than domestic purposes.
On-site	Works carried out or proposed to be carried out within the site boundary.
Off-site	Works carried out or proposed to be carried out outside the site boundary.
Point of connection	The nearest practical location where the existing water main or sewer is the same size or larger than the new connecting main or sewer.
Requisition Charge	Charges that will be imposed by that undertaker for work carried out by it in accordance with the duties imposed by section 41(1) (provision of requisitioned Water Main) and section 98(1) (provision of requisitioned public sewer) of the Water Industry Act 1991. That is, a charge set by the water company for the provision of the new water main or public sewer (a requisition) to recover the costs reasonably incurred in providing them.
Self-Lay	The laying of water pipes and associated infrastructure in accordance with section 51a of the Act.
Self-lay provider (SLP)	An accredited operative who can lay the pipework for a new water main or sewer rather the infrastructure being laid by the water company. The water company will take over responsibility for self-laid pipes that meet the terms of its agreement.
Service Connection	The construction of the pipe between the supply pipe of the premises and the public water main which is provided under section 45 and 46 of the Act.
Service Pipe	So much of a pipe which is, or is to be, connected with a water main for supplying water from that main to any premises as — (a) is or is to be subject to water pressure from that main; or (b) would be so subject but for the closing of some valve, and includes part of any service pipe.

Term	Description
Site Specific	Work on, or the provision of, water or sewerage structures or facilities located on a development as well as work to provide and connect a requested water main, sewer, communication pipe or lateral drain on, to or in the immediate vicinity of, the development. Charges for site specific work relate to the provision of connection structures or facilities located on a development up to the nearest practical point on the existing network where the connecting pipework is of a nominal bore internal diameter no larger than that of our existing network. They do not refer to costs or work required as part of network reinforcement.
Undertaker	A water undertaker or sewerage undertaker.
Unmade ground (verge)	Refers to ground which does not have a surface. For example, unmade ground may feature grass and topsoil.
Water main	Any pipe, not being a pipe for the time being vested in a person other than the Water Undertaker, which is used or to be used by a Water Undertaker or licensed water supplier for the purpose of making a general supply of water available to customers or potential customers of the Water Undertaker or water supply licensee, as distinct from for the purpose of providing a supply to particular customers. This definition includes tunnels or conduits which serve as a pipe and any accessories for the pipe.
Water Undertaker	A company appointed under the Water Industry Act 1991 to provide water services to a defined geographic area and which owns the supply system and other infrastructure.