



Llywodraeth Cymru  
Welsh Government

# Charging guidance to Ofwat (the economic regulator of the water sector)

2016

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# 1. Introduction

1.1. This guidance is issued to Ofwat the independent economic regulator of the water sector under section 144ZE of the Water Industry Act 1991 as inserted by section 38 of the Water Act 2014: General guidance on charges. Ofwat must have regard to any guidance issued under this section by Welsh Ministers when making Charges Rules that apply in areas that are wholly or mainly in Wales..

1.2. This is the first Charging Guidance that the Welsh Government has produced following the introduction of new powers for Welsh Ministers in the Water Act 2014, reflecting the Welsh Government's policy. This replaces existing Charging Guidance to Ofwat for relevant undertakers, which the UK Government produced in 1999<sup>1</sup>.

1.3. Section 144ZE of the Water Industry Act 1991 provides powers for the Welsh Ministers to give guidance to Ofwat, relating to the rules as to the charges that may be imposed by relevant undertakers in areas wholly or mainly in Wales. This Guidance will set out principles which specifically apply to:

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

1.4. More detailed information on each of the particular provisions on charging regimes is provided in Annex 1.

1.5. The purpose of this Guidance is to set a framework along side any other Guidance the Welsh Ministers may provide which Ofwat must have regard to when it sets charging rules.

1.6. Ofwat's charging rules will be subject to public consultation. Welsh Ministers have a power to direct Ofwat not to issue the rules, if they consider that the rules are not consistent with the Welsh Government's policy. Where the Welsh Government issues revised guidance, the Act requires that Ofwat should review and, if necessary revise, the relevant charging rules.

1.7. The Welsh Ministers have, where practicable, given due consideration to costs and benefits which may be expected to result from the Guidance.

1.8. Defra have issued separate Guidance which is applicable to Ofwat's rules relating to undertakers wholly or mainly in England.

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<sup>1</sup> In the guidance, reference to Relevant Undertakers refers to water undertakers and water and sewerage undertakers who operate wholly or mainly in Wales.

## 2. The Role of Ofwat

2.1. The Water Services Regulation Authority (Ofwat) is the independent economic regulator for the water and sewerage sector in England and Wales. The Water Act 2014 introduced new powers for Ofwat with regards to issuing charging rules around what relevant undertakers can charge for water supply and sewerage services.

2.2. Ofwat's general duties as a regulator are laid down in Section 2 of the Water Industry Act 1991 (WIA91)<sup>2</sup> Ofwat must:

- Further the consumer objective.
- Secure that the functions of water and sewerage undertakers are properly carried out across Wales and England.
- Secure that companies holding appointments under Chapter 1 of Part 2 of the Water Industry Act 1991 as relevant undertakers are able (in particular, by securing reasonable returns on their capital) to finance the proper carrying out of those functions.
- Secure that the activities authorised by the licence of a licensed water supplier and any statutory functions imposed on it in consequence of the licence are properly carried out.
- Further the resilience objective.

2.3. Subject to these duties, Ofwat must also:

- Promote economy and efficiency by relevant undertakers in their work.
- Secure that no undue preference or discrimination is shown by such companies in fixing charges.
- Secure that consumers' interests are protected in relation to any unregulated activities of companies.
- Contribute to the achievement of sustainable development.

2.4. In addition, Ofwat must have regard to the principles of best regulatory practice.

2.5. These duties are supplemented by general duties in relation to the environment and recreation (see, for example, sections 3 and 4 of the Water Industry Act 1991). Ofwat also has a range of regulatory functions under the Competition Act 1998 and the Enterprise Act 2002.

2.6. The Welsh Government's role is to determine the policy framework that may affect the factors that determine price limits and to bring to Ofwat's attention the Welsh Ministers' priorities for relevant undertakers wholly or mainly in Wales. This includes improvements to natural resources and

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<sup>2</sup> (<http://www.legislation.gov.uk/ukpga/1991/56/contents>), as amended by the Water Act 2003 (<http://www.legislation.gov.uk/ukpga/2003/37/contents>).

drinking water services in Wales. In doing so we must seek to ensure that we meet our domestic and European legislative obligations.

### **3. The Welsh Government's policy priorities for Charging Guidance**

3.1. The Welsh Government's vision for water is to ensure that Wales continues to have a thriving water environment which is sustainably managed to support healthy communities, flourishing businesses and biodiversity. We want the people of Wales to receive first class, value for money water services with water used efficiently, safely and respectfully by all.

3.2. Ofwat has an important role in supporting the delivery of our vision when undertaking their independent economic regulatory duties.

3.3. We expect Ofwat to take account of our Charging Guidance within the context of our overarching policy commitments for the water sector in Wales and the wider goals and principles of the Welsh Government. These include:

- The Welsh Government Water Strategy for Wales<sup>3</sup> issued in May 2015
- The Well-being of Future Generations (Wales) Act (2015)<sup>4</sup>
- The Environment (Wales) Act 2016<sup>5</sup>
- The Social and Environmental Guidance to Ofwat<sup>6</sup> issued under section 2A of the Water Industry Act 1991 (as amended by section 40 of the Water Act 2003) issued in June 2014
- The forthcoming Welsh Government Strategic Policy Statement issued under the Water Act 2014

3.4. The Welsh Government is issuing Charging Guidance under Section 144ZE of the Water Industry Act 1991. We have drafted this Guidance within the context of two key themes of the Water Strategy for Wales:

- Delivering excellent services to customers
- Water for nature, people and business

3.5. We expect Ofwat to balance the long-term needs of a sustainable and resilient environment with the need to ensure that there are sufficient, reliable water resources. Ofwat should provide incentives that give the right balance between rewards and penalties in the context of Welsh Government priorities and circumstances in Wales. Where there are conflicting priorities we would like to see Ofwat explain within their rules how they have balanced these competing objectives.

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<sup>3</sup> <http://gov.wales/topics/environmentcountryside/epq/waterflooding/publications/water-strategy/?lang=en>

<sup>4</sup> See Annex 2

<sup>5</sup> <http://gov.wales/legislation/programme/assemblybills/environment-wales-act-2016/?lang=en>

<sup>6</sup> <http://gov.wales/topics/environmentcountryside/epq/waterflooding/publications/social-environmental-guidance-water/?lang=en>

## Delivering Excellent Services to Customers

3.6. The Water Strategy for Wales highlights the importance of ensuring a strong customer focus at the heart of the delivery of water and sewerage services in Wales. This requires both a sound understanding of existing and future customer needs, and a strong voice for consumer representation. The Welsh Government expects Ofwat, within the scope of their duties, to encourage water companies to know their customers and set out in their charging 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 number of customers falling into arrears and to agree payment arrangements to address arrears with as many customers as possible.

3.7. The Welsh Government expects the framework of water charging to be one in which there is a fair allocation of costs between customers, recognising affordability for customers and the costs of providing the service. Ofwat should set clear expectations that in developing their charging schemes, the companies must undertake proportionate assessment of the impacts of any significant incidence (burden) effects on customers as a whole, or on groups of customers, and act on the results.

3.8. Ofwat should take account of the affordability issues specific to Wales and ensure that these are reflected in its approach to regulating charges for Welsh customers. Ofwat should therefore give due consideration to innovative charges from relevant undertakers, including social tariffs, in line with the Welsh Government Social Tariff Guidance<sup>7</sup>, to help address affordability issues. The Welsh Government expects Ofwat to be supportive of relevant undertakers' proposals for charges which are both fair and protect vulnerable and low income groups.

3.9. Ofwat should take a proportionate regulatory approach that recognises the costs and burdens that regulation can place on the relevant undertakers and 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 relevant undertakers and the customers affected.

3.10. We expect Ofwat and the water undertakers to comply with the Welsh Language (Wales) Measure 2011. Ofwat and water undertakers are expected to comply in due course with the relevant Welsh Language Standards imposed upon them by the Welsh Language Commissioner. The Measure establishes that, in Wales, the Welsh language should not be treated less favourably than the English language. The Welsh Government expects undertakers to publish their charges schemes bilingually.

## Water for Nature, People and Business

3.11. The Welsh Government is keen to take a long-term, 25 years plus

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<sup>7</sup> <http://gov.wales/topics/environmentcountryside/epq/waterflooding/publications/social-tariff-guidance/?lang=en>

approach to natural resource which will support our focus on sustainable development. By enhancing and managing our natural environment more holistically, we will not only secure our environmental wellbeing but also maximise the economic and social benefits for the long term.

3.12. The efficient use of water resources is fundamental to securing the long term resilience of water supplies and the environment. The Water Act 2014 introduced a primary duty which requires Ofwat to secure the long-term resilience of water and sewerage systems and provision of services to customers; taking into account environmental pressures, population growth and changes in consumer behaviour. We expect Ofwat to have regard to their duties and to ensure that relevant undertakers have a range of measures in place to manage water resources in sustainable ways. This should include increasing efficiency in the use of water and reducing demand for water in order to reduce pressure on water resources.

3.13. Ofwat must also have regard to their duty to sustainable development. Ofwat has a duty under the Water Industry Act 1991 (as amended) to exercise and perform its powers and duties in a manner it considers is best calculated to contribute to the achievement of sustainable development. To ensure that the interests of the consumers are at the heart of decisions about the water sector, Ofwat should take account of the Welsh Government definition of sustainable development as stated in the Well-being of Future Generations (Wales) Act 2015.

3.14. The Welsh Government expects Ofwat to ensure that a proportionate assessment of the impacts on both consumers and investors of any proposed changes to its regulatory framework for the water and sewerage sector has been carried out. Any proposed changes should be driven and set out in the context of Welsh Government policy and Welsh Legislation, and any supporting evidence should be based on data solely from undertakers that are wholly or mainly in Wales or within the geographical boundary of Wales. Where proposed changes apply to both England and Wales, separate consultation and explanatory notes should be provided for England and Wales, each setting out the proposals within the context of the different Government policies and legislative framework.

3.15. Charging can play a role in securing 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. The Welsh Government therefore, sees no case for any moves towards the de-averaging of network costs. 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 measureable 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 the decision about where to locate new premises, it would make sense for them to consider 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.

3.16. The Sustainable Urban Drainage Systems (SuDS) approach is central to future surface water management, and can be used to help comply with European, UK and Welsh environmental and water quality legislation. SuDS schemes can reduce the volume and flow of excess surface water entering the sewerage infrastructure. In line with their legal and regulatory duties, sewerage undertakers may adopt SuDS features and infrastructure. We expect, in general, for relevant undertakers to recover the associated costs through their charges schemes and customer agreements.

# Guidance on Charging Schemes

## 4. Guidance on Charging schemes for household customers

### Delivering excellent services to customers

4.1. The Welsh Ministers expect Ofwat to take account of the respective policy positions of the Welsh Government and UK Government. Any divergence in policy between the UK and Welsh Governments must be fully reflected in regulatory policy and practice, and Welsh consumers must not be detrimentally affected.

4.2. Under section 2 of the Water Industry Act 1991, Ofwat has a duty to protect the interests of consumers, including (where appropriate) by promoting effective competition in the provision of water and sewerage services. As set out in paragraphs 3.7 and 3.8 Ofwat must have 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.

### Fair and Affordable Water services

4.3. The Tackling Poverty Action Plan<sup>8</sup> sets out the Welsh Government's key objectives to prevent poverty in the long term, to help people out of poverty and mitigate the impact of poverty. The action plan recognises that there is a need to become more joined up with our partners to achieve better outcomes for everyone in Wales. We are committed to improving the lives of those living in poverty and keeping water bills at an affordable level will help reduce debt and protect vulnerable groups.

4.4. The Welsh Government's ambition is a Wales where everyone achieves their full potential and everyone can live a life free from poverty and inequality. We are particularly concerned about the impact of water charges and the impact of rises in water bill on those customers least able to pay. This is especially important when considered alongside other utility and household bill increases.

4.5. Ofwat should take into account affordability issues specific to Wales and ensure that these are reflected in Ofwat's approach to regulating charges. Ofwat should give due consideration to innovative charges from undertakers including social tariffs, in line with Welsh Government Social Tariff Guidance, to help address affordability issues. Where appropriate, Ofwat should seek to involve officials from the Welsh Government and the Consumer Council for Water in this work.

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<sup>8</sup> <http://gov.wales/topics/people-and-communities/tackling-poverty/taking-forward-tackling-poverty-action-plan/?lang=en>

## **Social Tariffs**

4.6. Social tariffs will enable customers who are less able to pay their bills to access reduced charges, as well as additional support around how to reduce costs through water efficiency measures or consideration of moving to metered charges, for example.

4.7. The Welsh Government published its Social Tariff Guidance to Ofwat and the water companies on 10 June 2014. This Guidance sets the framework with which relevant undertakers can bring forward a social tariff if it chooses to do so and also set the framework which Ofwat should consider when exercising its power to regulate charging schemes.

4.8. The Welsh Ministers will expect Ofwat to consider their Social Tariff Guidance when regulating any future charges proposed by relevant undertakers in Wales.

4.9. The Welsh Ministers are keen to encourage the development of innovative charging structures additional to the social tariffs to ensure that households with affordability issues are protected.

## **Payment Schemes**

4.10. Debt can often be linked to a householders' ability to pay. Relevant undertakers should provide support to ensure that vulnerable householders and those living in poverty are able to pay for their water bill whilst at the same time, actively pursuing those householders who choose not to pay their bills. By offering support, relevant undertakers will be able to reduce the current level of bad debt. The Welsh Ministers would expect Ofwat to encourage relevant undertakers to meet the needs of their customers and offer appropriately targeted tariffs and payment plans to help minimise the number of households falling into debt and to maximise the numbers addressing their debts.

4.11. The level of bad debt in England and Wales is believed to add approximately £21 per year to each bill. In January 2015, the Welsh Government introduced the Water Industry (Undertakers Wholly or Mainly in Wales) (Information about Non-owner Occupiers) Regulations 2014 to make it easier for relevant undertakers to find out information on non-owner occupiers of households and enable them to seek payment more easily. Welsh Ministers expect Ofwat to take account of these regulations in Wales by being supportive of relevant undertaker's proposed schemes for charges which are both fair and protect vulnerable and low income groups.

4.12. Those on low incomes may find the size and infrequency of annual or bi-annual bills particularly difficult to manage. Welsh Ministers expect flexible payment options to be offered to customers to assist with these problems. In particular, customers should be able to make frequent payments (such as weekly or fortnightly). Ofwat should encourage relevant undertakers to provide a wide range of options on where and when payments can be made. This should include allowing customers to pay irregular amounts on a frequent

basis. Ofwat should promote such schemes that do not incur an additional charge for customers. Charges schemes should make clear that these options are available and they should be drawn to the attention of customers most in need of assistance.

4.13. It is important to recognise that not all households will want to (or will be able to) pay their bills using Direct Debit. It is critical that low income households are not disadvantaged and do not end up paying more for their water bills, if they are unable to pay by Direct Debit than those who are able to pay by Direct Debit. Families living in poverty are often at risk of experiencing the “poverty premium” where low income households pay disproportionately more for goods and services. Relevant undertakers should recognise these limitations of Direct Debit payment and Ofwat should encourage proposals to address this. In so doing, they will make an important contribution to one of the objectives of the Welsh Government’s 2015 Child Poverty Strategy<sup>9</sup>, which is aimed at supporting families living in poverty to increase household income through debt and financial advice and action to address the “poverty premium”.

### **Stable and predictable charges**

4.14. Stability and predictability in bills can be particularly important to customers who have to plan carefully for future costs. Customers have a legitimate expectation that, where their use of water services does not change markedly from one year to the next, they should not face changes in costs significantly out of line with changes to the overall undertaker price limit. Charges schemes should ensure that, under existing charges, changes to individual bills should not diverge significantly from the average without changes in demand. Phasing in of any sudden large changes in charges, through the use of devices such as glide paths, can be useful in managing effects on customer bills and should be encouraged. Relevant undertakers and retailers are encouraged to consult customers and introduce changes to charges in a sensitive way.

### **Transparent and customer focused charging**

4.15. Welsh Ministers expect charges schemes and customer bills to be both transparent and fair.

4.16. For most household customers, their overall bill comprises a charge for the water service and charges for three elements of the sewerage service - foul water drainage, surface water drainage and highway drainage. Charges schemes that separate out sewerage charges in a way that customers find transparent and relevant, should be encouraged where it can promote positive behaviour change.

4.17. Welsh Ministers welcome and support the provision of rebates for customers whose surface water does not flow either into public sewers or

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<sup>9</sup> <http://gov.wales/topics/people-and-communities/people/children-and-young-people/child-poverty/?lang=en>

SuDS features and infrastructure that have been adopted by the sewerage undertaker. Information on the numbers of properties which do not receive a surface water drainage service is not comprehensive. Relevant undertakers should seek to obtain better information on this matter, and should consider the scope for offering automatic rebates in such circumstances while bearing in mind the need to avoid unacceptable increases in other customers' bills, if such an approach is to be adopted.

4.18. Welsh Ministers welcome the approach Ofwat has adopted in the 2014 Price Review where undertakers were given greater ownership of their business plans with extensive input from the Customer Challenge Groups, in order to deliver long term outcomes. We expect Ofwat to continue to encourage relevant undertakers to take note of customer expectations where it is appropriate while continuing to ensure that Ministerial requirements and compliance with statutory duties continue to be taken into account.

### **Natural Resource Management Incentives**

4.19. We expect Ofwat to encourage relevant undertakers to facilitate a reduction in domestic and business water use. The promotion of water efficiency and water conservation are encouraged in mitigating the environmental impact of society's demand for water and in protecting the aquatic environment for future generations. A wide range of measures should be considered to help reduce demand for water - for example, relevant undertakers are already required to reduce leakage from their pipes and the majority of the industry provides free leakage detection and repair services for household consumers.

4.20. Water meters have a role in providing an incentive to reduce water consumption and in some circumstances they can reduce bills.

4.21. The design of measured charges can play an important role in improving water efficiency, reducing water consumption and abstractions, and enhancing the environment. There may also be an environmental and economic gain for customers generally if the effect of metering can defer the need for expensive investments in new resources.

4.22. In this context, the Welsh Government recognises that innovative tariff structures can send positive price signals and improve economic and environmental efficiency. For example, rising (fixed and amended) block tariffs, which charge more per volumetric unit of water for each subsequent block of water used, can mean a lower volumetric rate is charged for essential use and a higher volumetric rate is charged for discretionary use. This can provide an incentive to reduce discretionary water use whilst still giving access to water for basic needs at low cost. Seasonal tariffs and time-of-day tariffs can also tackle peak water uses where these affect the required capacity of the system.

4.23. Introduction of such tools needs to be properly managed and 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, but should always include provisions for potentially vulnerable customers within the trials.

4.24. Relevant undertakers should regularly develop and review tariffs to ensure that they are relevant to their customers' needs and concerns, as well as providing encouragement for water conservation and efficiency. Welsh Ministers want to see further development of tariffs which provide stronger incentives to economise on the use of water for discretionary purposes, without discouraging essential use - for example, rising block tariffs. A balance will always need to be struck to ensure that tariffs remain as transparent, affordable and fair as possible, as evidence from the energy retail market has suggested that multiple tariff structures only benefits 'well-informed' (and often better off) customers at the expense of less 'well-informed', and often more vulnerable customers.

4.25. Where customers are using significant quantities of water for discretionary purposes, it is right that the price mechanism should reflect extra costs which arise from the additional consumption and those customers should be made aware of the resources they are using.

4.26. Regional average based charging has recognisable benefit to customers as a whole. For the purpose of this Guidance area based charging should remain; the Welsh Government may choose to give more detailed advice on this position in future Guidance.

4.27. Ofwat is expected to have regard to the Welsh Government's priorities set out in the National Natural Resource Management Policy which, subject to being passed by the National Assembly for Wales, will be a statutory document under the Environment (Wales) Act 2016. It should incentivise water undertakers to develop long-term, innovative solutions where appropriate, based on whole catchment approaches, and recognising the role and function of natural processes.

4.28. Ofwat should have regard to the fact that there is support in principle from customers for relevant undertakers to carry out activities within their competence that provide wider environmental benefits, such as the promotion or protection of biodiversity, energy generation, landscape benefits, regulation of flood risks or the provision of environmental information and education to promote behaviour change around water use or appropriate use of the drainage system.

## **Metering**

4.29. In setting charging rules, Ofwat should always seek to ensure that any transition to metering by relevant undertakers are handled with care, recognising that water bills may also rise for some customers who do not move to a meter. It should make sure that, wherever appropriate, measures such as transitional tariffs are put in place by the relevant undertakers 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 Welsh Government's view is that if any undertaker wishes to introduce a

more widespread metering programme across its operating area it must seriously consider including a company social tariff in its charges scheme<sup>10</sup>.

4.30. Welsh Ministers consider that Ofwat should ensure that the timescales set out in charges schemes strike an appropriate balance between responding rapidly to the serving of measured charges notices and the cost-effective operation of the meter installation programme. The speed of response will vary according to the level of demand for meters. But it is also in the wider interests of customers for companies to ensure that the programme of meter fitting is managed as efficiently and cost effectively as possible.

4.31. Welsh Ministers expect that unmeasured households, who would benefit most from having a meter installed and moving to a measured charging system, should be made aware that doing so would benefit them. Once they have made the decision to move, they should be moved onto a meter as quickly as possible in order to benefit from bill savings.

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<sup>10</sup> 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.

## **5. Guidance on Charging schemes for non-household Customers**

### **Non-household customers**

5.1. Non-household customers have similar expectations to those of household customers in respect to fair, affordable, stable, predictable and transparent charges.

5.2. The Welsh Ministers expect to see fair treatment for non-household customers whose areas are wholly or mainly in Wales. The charges paid by many non-household users will be set under charges schemes, to which this Guidance relates.

5.3. Non-household customers occupy diverse types of premises and use water and sewerage services in different ways. In Wales, there are already companies who rely on water to support everything from paper and steel production through to food processing and brewing. Where this affects the pattern of water use, water undertakers should be prepared to recognise this and consider distinctive charges that reflect the burdens customers place on the water system. Non-household customers in Wales are metered. This should facilitate fair treatment of different users in these categories.

5.4. Regional average based charging has recognisable benefit to customers as a whole. For the purpose of this Guidance regional average based charging should remain and the Welsh Government may choose to give more detailed advice on this position in future guidance.

### **Taking account of Wales specific policy**

5.5. The Welsh Ministers expect Ofwat to take account of the different respective policy positions of the Welsh Government and UK Government. Any divergence in policy between the UK and Welsh Governments must be fully reflected in Ofwat's regulatory policy and practice, and Welsh consumers must not be detrimentally affected. We expect different rules to be issued by Ofwat where there are policy divergences between the UK Government and Welsh Government.

5.6. Business customers, whether commerce or industry, use water services in the course of their operations. Welsh Ministers would expect business customers as a whole to meet the full cost of their retail and wholesale services, and so not be subsidised by (or subsidising) domestic customers. We expect Ofwat to ensure customers served wholly or mainly in Wales do not make contributions towards the costs of market reform under the Water Act 2014.

5.7. Stability and predictability in bills can be particularly important for both business and other non-household customers who have to plan carefully for future costs. Non-household customers have a legitimate expectation that,



where their use of water services does not change markedly from one year to the next, they should not face changes in costs significantly out of line with changes to the overall undertaker price limit. Charges schemes should ensure that, under existing charges, changes to individual bills should not diverge significantly from the average without changes in demand. Phasing in of any sudden significant changes in charges should be considered. Relevant undertakers and retailers should be encouraged to consult customers and introduce changes to charges in a sensitive way.

5.8. 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 to improve efficiency of their water use and reduce the cost of their bill in the future. Charges should 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.

5.9. From April 2017 non-household customers served by an undertaker wholly or mainly in England will have the option to switch their supplier of retail services. This will not apply for most non-household customers served by relevant undertakers wholly or mainly in Wales.

5.10. Ofwat will be required to set the rules on charges within the context of Welsh Government policy relating to market reform. We expect Ofwat to keep the impact of market reform under review and, where necessary take action to ensure that the retail charges received by non-household customers served wholly or mainly in Wales remain both fair and affordable.

5.11. Ofwat will continue to regulate in order to maintain sufficiently low price volatility and to protect those non-household customers eligible for retail competition that choose not to switch, by establishing default tariffs.

### **Bulk Charges**

5.12. In setting charging rules in respect of 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. These charges should be transparent and predictable where possible. The Welsh Government also expects Ofwat to ensure that these supplies are not subsidised by domestic customers. The Welsh Government may give more detailed advice on this position in future guidance.

### **Access Pricing**

5.13. For the purpose of this Guidance the Welsh Government expects Ofwat to work within the [current legal framework in respect of the undertakers wholly or mainly in Wales](#). . If Ofwat feel there is an appropriate need to diverge with this approach, this would need to be discussed and agreed with the Welsh Government. The Welsh Government are in the process of reviewing this and will give updated advice on this position in future guidance.

## **Section 144ZA Developer charges**

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

5.15. The Welsh Ministers will prepare further detailed guidance to Ofwat on developer charges, in accordance with Section 144ZD of the Water Industry Act, as inserted by the Water Act 2014. This will set out the Welsh Government's expectations for Ofwat's charging rules in relation to developers. However, for the purpose of this Guidance we expect Ofwat to continue to facilitate a simple, fair and transparent charging structure for the relevant undertakers to abide by. Ofwat should set rules that enable water and sewerage undertakers to recover the costs reasonably incurred in the provision of infrastructure.

## **6. Conclusion**

This document sets out the Welsh Minister's Guidance on the exercise of Ofwat's power to set charges scheme rules for relevant undertakers in areas wholly or mainly in Wales.

## 7. Annex 1

### The Water Act 2014 – a new framework for charging

The Water Act 2014 introduced a number of changes to legislation to support the Welsh Government's overarching policy objectives for the water sector. This included 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 for Ofwat, setting out a policy framework for Ofwat's approach to regulating charges.

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

- rules under section 66E in relation to the charges which water undertakers impose on water supply licensees;
- rules under section 117I<sup>11</sup> 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;

In addition to this, the Act provides that Welsh Ministers 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.

Furthermore, the Welsh Ministers may also issue general guidance about the principles to be applied by Ofwat setting rules about charges that may be

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<sup>11</sup> Not currently devolved to Wales

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.).

Ofwat's charging rules will be subject to public consultation. The Welsh Ministers have a power in respect of relevant undertakers to direct Ofwat not to issue the rules, for example, where rules are not consistent with Welsh Government policy. Where the Welsh Government issues revised guidance, the Act requires that Ofwat should review and, if necessary revise, the relevant charging rules.

In addition to this overarching statement of charging policy and principles, the Welsh Ministers are required in some instances to issue guidance in relation to the content of the particular charging regimes, duties and powers to issue further, more detailed guidance on each of the particular charging regimes issues listed 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 in relation to content is required at a later date. For example, Welsh Ministers must use the power in section 144ZD to publish guidance on the content of the rules about charges for connections that relevant undertakers may make to developers.

The Act also provides that Welsh Ministers may issue guidance about the content of the rules under section 143B to be applied by Ofwat.

The Act also provides that Welsh Ministers must issue guidance as to the content of the rules under section 144ZA.

## 8. Annex 2

### Well-being of Future Generations (Wales) Act 2015

The Well-being of Future Generations (Wales) Act 2015 sets out seven goals which provide a shared vision and framework for its activity. The Act also requires the Welsh Government to demonstrate it has applied five key behaviours when making decisions, through the sustainable development principle. We want Ofwat to work towards the seven goals and take account of the sustainable development principle in how it goes about its work.

The Well-being of Future Generations (Wales) Act 2015 Seven Goals:

1. A prosperous Wales – An innovative, productive and low carbon society which recognised the limits of the global environment and therefore uses resources efficiently and proportionately (including action on climate change); and which develops a skilled and well-educated population in an economy which generates wealth and provides employment opportunities, allowing people to take advantage of the wealth generated through securing decent work.
2. A resilient Wales – A nation which maintains and enhances a biodiverse natural environment with healthy functioning ecosystems that support social, economic and ecological resilience and the capacity to adapt to change (for example climate change).
3. A healthier Wales – A society in which people's physical and mental well being is maximised and in which choices and behaviours that benefit future health are understood.
4. A more equal Wales – A society that enables people to fulfil their potential no matter what their background and circumstances (including their socio economic background and circumstances).
5. A Wales of cohesive communities – Attractive, viable, safe and connected communities.
6. A Wales of vibrant culture and thriving Welsh language – A society that promotes and protects culture, heritage and the Welsh language, and which encourages people to participate in the arts, sports and recreation.
7. A globally responsible Wales – A nation which, when doing anything to improve the economic, social, environmental and cultural well being of Wales, takes account of whether doing such a thing may make a positive contribution to global well-being.

5 Key behaviours:

1. **Long-term** – balancing short-term needs with the need to safeguard the ability to also meet long-term needs;
2. **Prevention** – acting to prevent problems occurring or getting worse
3. **Integration** – considering how the objectives of the organisation may impact upon each of the well-being goals, on their objectives, or on the objectives of other public bodies;

4. **Collaboration** – acting in collaboration with any other person, or different parts of the public body itself, that could help the body meet its well-being objectives;
5. **Involvement** – involving people with an interest in achieving the well-being goals, and ensuring that those people reflect the diversity of the area which the body serves.