



Connecting to the System

**Consultation on Paying for Connections to the
Water and Sewerage Networks**

August 2005
Paper 2005/19

Scottish Executive Environment Group

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Water and Sewerage Networks**

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Consultation Information and Arrangements

Responding to this consultation paper

We are inviting written responses to this consultation paper by **Thursday, 17 November**.

Please send your response to:

waterdivision@scotland.gsi.gov.uk

or

Scottish Executive Environment and Rural Affairs Department
Water Division
Area 1-H
Victoria Quay
Leith
Edinburgh
EH6 6QQ

If you have any queries, please contact Iain Morrison on 0131 244 7819.

We would be grateful if you could clearly indicate in your response which questions or parts of the consultation paper you are responding to as this will aid our analysis of the responses received. An optional consultation response form which can simply be filled in is available to assist respondees. Copies of this are available from the contact details above.

This consultation, and all other Scottish Executive consultation exercises, can be viewed online on the consultation web pages of the Scottish Executive website at <http://www.scotland.gov.uk/consultations>. You can telephone Freephone 0800 77 1234 to find out where your nearest public internet access point is.

The Scottish Executive now has an email alert system for consultations called SEconsult, which can be found at <http://www.scotland.gov.uk/consultations/seconsult.aspx>). This system allows individuals and organisations to register and receive a weekly email containing details of all new consultations (including web links). SEconsult complements, but in no way replaces SE distribution lists, and is designed to allow stakeholders to keep up to date with all SE consultation activity, and therefore be alerted at the earliest opportunity to those of most interest. We would encourage you to register.

Handling your response

We need to know how you wish your response to be handled and, in particular, whether you are happy for your response to be made public. Please complete and return the **Respondee Information Form** enclosed with this consultation paper as this will ensure that we treat your response appropriately. If you ask for your response not to be published we will regard it as confidential and we will treat it accordingly.

All respondees should be aware that the Scottish Executive is subject to the provisions of the Freedom of Information (Scotland) Act 2002 and would therefore have to consider any

request made to it under the Act for information relating to responses made to this consultation exercise.

Next steps in the process

Where respondents have given permission for their response to be made public (see the attached Respondee Information Form), these will be made available to the public in the Scottish Executive Library by 15 December. They will also be placed on the Scottish Executive consultation web pages. We will check all responses where agreement to publish has been given for any potentially defamatory material before logging them in the library or placing them on the website. You can make arrangements to view responses by contacting the SE Library on 0131 244 4565. Responses can be copied and sent to you, but a charge may be made for this service.

What happens next?

Following the closing date, all responses will be analysed and considered along with any other available evidence to help us finalise the Regulations and reach a decision on any related issues. We aim to issue a report on this consultation process early in 2006. The final Regulations, taking account of consultation responses, are intended to come into effect in April 2006.

Comments and complaints

If you have any comments on how this consultation exercise has been conducted, please send them to Iain Morrison at the contact details on Page 3.

Executive Summary

This consultation sets out proposals and draft Regulations which will result in a change to the way Scottish Water contributes to the costs of new connections to its water and sewerage networks.

The draft Regulations clarify Scottish Water and developers' responsibilities for paying for new infrastructure. Developers will be responsible for paying for the immediate connection from a property to where it joins a water main or sewer. As set out in the Ministerial Statements on the water industry in February 2005, Scottish Water will be responsible for meeting all requirements for strategic infrastructure. Between these two responsibilities, the Regulations provide a clear basis for dividing the costs of new local infrastructure that reflects the costs and benefits of that infrastructure to both Scottish Water and the developer.

This division will provide that Scottish Water meets the costs of this local infrastructure up to a limit based on the future income that the new connection will bring, and that developers must meet any costs above this limit. This is fair to Scottish Water's existing customers, ensuring that, as far as possible, their charges go towards the service they receive, rather than subsidising new connections, and it is fair to new customers, recognising the charge income they will provide to Scottish Water.

The draft Regulations have the effect of clarifying the point at which Scottish Water is to make its contribution towards new connections. This will ensure that Scottish Water does not invest customers' money in advance of need, for example, at a point when a development may be delayed or cancelled.

Overall, the Regulations will continue Scottish Water's duty to make significant contributions to the costs of new connections to the public networks and provide a transparent economic justification for these contributions. However, in the minority of cases where the requirement for new local infrastructure is substantial, developers will meet all the excess costs that are not covered by Scottish Water's contribution, as it would not be appropriate for existing customers to have to bear such costs. The Regulations will provide developers with a clear understanding of the costs involved in connecting to the public networks, assisting them in reaching a commercial decision regarding a development.

Summary of consultation questions

The consultation questions set out in sections 4 and 5 of the paper are summarised below.

Question 1: Do you agree that Scottish Water's contribution should be targeted at all local infrastructure ('Part 2' and 'Part 3'), with developers funding immediate connections and Scottish Water funding strategic capacity?

If not, what approach would you support, and why?

Question 2: Should the Regulations define Scottish Water's contribution towards (a) domestic properties only, or (b) domestic and non-domestic properties?

Question 3: If the Regulations were to define reasonable cost for non-domestic properties, what method do you suggest should be used?

Question 4: Do you agree that Scottish Water's contribution should be limited to an amount based on future income from that connection and payable only when a development is well advanced?

If not, what approach would you support, and why?

Question 5: Do you have any comments on the proposed basis for calculating Scottish Water's reasonable cost contribution?

Question 6: What factors should be taken into account in setting the variables n and c , and why?

Question 7: Do you agree that connections for new properties and existing properties should be treated equally?

If not, what approach would you support, and why?

Question 8: Do you have any comments on the implications of the draft Regulations on development constraints?

Question 9: What, if any, provision on reserving capacity would you support and why?

1. Introduction

1.1 This consultation paper invites comments on proposals and draft Regulations to determine Scottish Water's contribution towards new connections of domestic properties to the public water and sewerage networks.

1.2 The draft Regulations are to be made under powers in the Water (Scotland) Act 1980 and the Sewerage (Scotland) Act 1968, as amended by Part 2 of the Water Environment and Water Services (Scotland) Act 2003¹. Subject to the outcome of this consultation, it is intended that these powers and the Regulations should be brought into force on 1 April 2006, coinciding with the start of Scottish Water's next regulatory period which is due to run from 2006 to 2010.

1.3 The Regulations are intended to provide a statutory method for calculating Scottish Water's contribution to new connections for domestic properties, based on the economic benefit of these connections. This will ensure that Scottish Water's contributions are transparent, and that they are fair to both new and existing customers. The Regulations will also provide clarity to Scottish Water and developers (including those in existing properties seeking a first time connection to the public networks) as to their responsibilities. This clarity, and Scottish Water's continued contributions towards these costs, will help address development constraints wherever these exist in Scotland and will facilitate the extension of the public networks.

1.4 As well as explaining and inviting comments on the policy behind these proposals and Regulations, this consultation paper includes a copy of the draft Regulations, accompanied by a commentary on their effect (in sections 6 and 7). A Partial Regulatory Impact Assessment is set out in section 8, which considers the costs and benefits of making the Regulations. **Comments on any aspect of the draft Regulations and Regulatory Impact Assessment are invited.**

1.5 For simplicity, this consultation refers generically to 'developers' to refer to all those seeking new connections, whether in the public or private sector, to Scottish Water's water and sewerage networks, and whether they are responsible for a large development or a single property.

¹ Acts which have been made since 1987 can be accessed free of charge from the Office of Public Sector Information's (OPSI) website (<http://www.opsi.gov.uk/cgi-bin/search.pl?DB=opsi>). Earlier legislation is available from The Stationery Office (<http://www.tsoshop.co.uk/bookstore.asp>).

2. Background Information

2.1 The Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2006, referred to in this paper as ‘the Reasonable Cost Regulations’ or ‘the Regulations’, will introduce a legal basis for apportioning costs towards the construction of water and sewerage infrastructure between Scottish Water and developers. This will replace the unregulated system which Scottish Water (and the previous water authorities) has operated up to now. The Regulations will reform this system, in line with commitments made during the passage of the Water Environment and Water Services (Scotland) Act 2003, and policy set out in the Ministerial Statements on the water industry in February 2005.

2.2 The Sewerage (Scotland) Act 1968 and the Water (Scotland) Act 1980 place similar duties on Scottish Water to take its public sewers and water pipes to such a point or points as to enable the owners of properties to connect to Scottish Water’s networks. This duty is qualified by provision limiting Scottish Water’s duty according to the costs involved. Section 1(3) of the Sewerage (Scotland) Act 1968 and section 6(2) of the Water (Scotland) Act 1980 provide, for sewerage and water connections respectively, that Scottish Water is not required to do anything “which is not practicable at a reasonable cost”. The draft Regulations concern the calculation of the ‘reasonable cost’ mentioned in these Acts, in order to clarify when Scottish Water’s legal duty to provide a connection is engaged. This has the effect of calculating what Scottish Water’s contribution to such a connection were it to be self laid is, and the maximum cost Scottish Water should incur directly in making the connection itself. In simple terms, this maximum cost can be thought of as ‘Scottish Water’s contribution’.

2.3 In practice, Scottish Water’s current policy is to fulfil these duties by making contributions or undertaking work itself up to a maximum value of £500 per new domestic water connection and £1,000 per new domestic sewerage connection. These levels of contribution apply to water connections for new and existing properties, and to sewerage connections for new properties. Scottish Water currently makes different levels of contribution for sewerage connections for existing properties, ranging from around £2,000 for a property in council tax band A, to around £6,000 for a band H property.

2.4 The Water Environment and Water Services (Scotland) Act 2003 made provision to replace this arbitrary system of contributions. It provided powers to make Regulations to determine matters to be taken into account, the criteria to be applied and the method of calculating what ‘reasonable cost’ should be. The draft Regulations therefore specify which parts of the water and sewerage infrastructure the reasonable cost calculation will apply to and provide a formula to determine how reasonable cost is to be calculated for both water and sewerage connections to domestic properties. At present, the Regulations do not define a method of calculating reasonable cost for connections to non-domestic properties, given the wide diversity of non-domestic properties and their water and sewerage needs. This issue is discussed further in paragraphs 4.7 to 4.10, and is the subject of consultation questions 2 and 3.

2.5 These proposals and the draft Regulations make it clear which parts of the infrastructure required to make a new connection are solely the responsibility of Scottish Water or a developer, and where responsibility is shared.

2.6 They will also make it clear that contributions will only be made when the development is clearly going ahead, and in the case where Scottish Water is providing funds

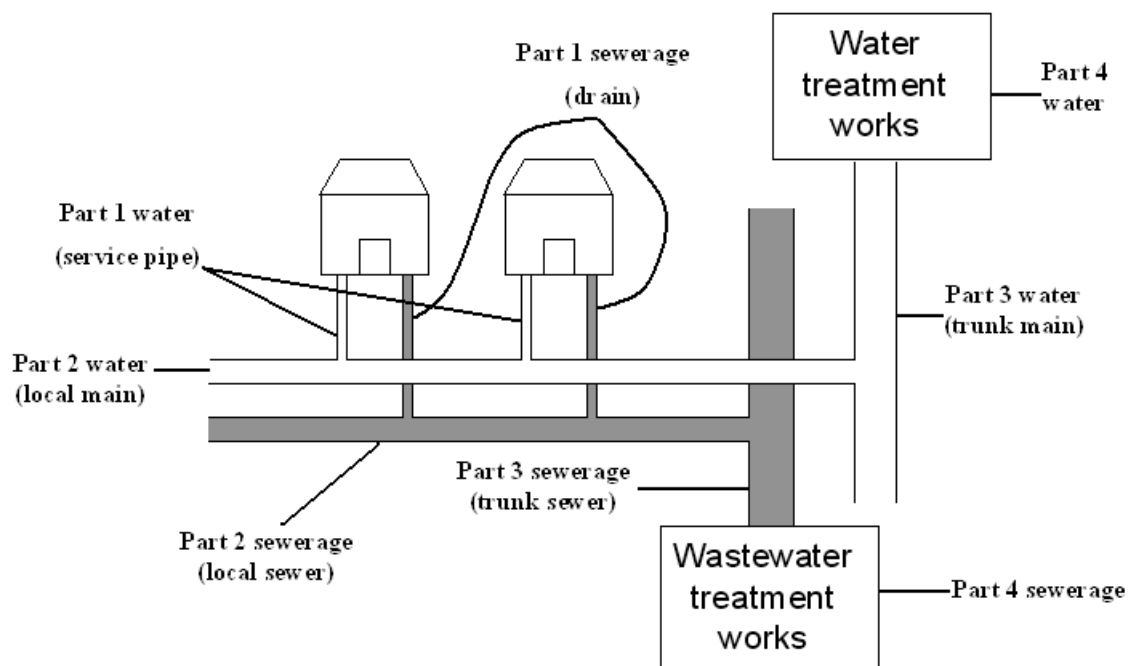
to a developer carrying out work, that Scottish Water’s payment will only be made when the work has been carried out satisfactorily. This will reduce the risk that Scottish Water incurs costs without any financial return, for example, if a development does not go ahead, is less extensive than originally envisaged, or the charge income never recoups Scottish Water’s initial outlay.

What is involved in a water or sewerage connection?

2.7 Scottish Water’s infrastructure (all the water or sewerage pipes, works or other equipment for the collection, treatment and movement of water and wastewater) is sometimes divided into four parts for ease of reference.

- Part 1: Connections from the boundary of individual premises to a main or sewer.
- Part 2: Water mains and sewers that connect developments (e.g. a street of houses) to the trunk mains and trunk sewers, and some sustainable urban drainage (SUD) systems.
- Part 3: Local strategic infrastructure, such as trunk mains and trunk sewers, water service reservoirs, wastewater pumping stations, and some SUD systems.
- Part 4: Strategic assets such as raw water intakes, water impounding reservoirs and aqueducts, and water and wastewater treatment works.

2.8 This consultation proposes a reasonable cost contribution towards the costs of funding ‘Part 2’ and ‘Part 3’ infrastructure, usually simply terming these “local infrastructure”. The following diagram provides a schematic illustration of a very simple water and sewerage connection. Depending on the systems already in place, location, and many other factors, additional or different types of infrastructure might be required.



Infrastructure charge

2.9 The proposed arrangements mean that developers will in future be responsible for local network reinforcement, but in such a way that the prospective income from the new connections will be recognised by continuing Scottish Water's duty to make 'reasonable cost' contributions. This will mean that there will be occasions where developers can take advantage of existing local network capacity. There will also be situations where developers are required to fund the release of local constraints in order to allow their development to proceed.

2.10 However, there may also be occasions where local network constraints have arisen because of a general background growth in demand which cannot reasonably be attributed to any individual or group of developers. In order that arrangements are put in place to address this situation, the Scottish Executive proposes to allow Scottish Water to introduce an 'infrastructure charge' for new connections. Such a charge will require that the broader reinforcement of the network, where such reinforcement is neither of a strategic nature nor can be attributable to any individual development or group of developments, is funded collectively by all new development. Such a charging arrangement is similar to the practice operating in other utilities, including the water companies in England and Wales.

2.11 The proposed infrastructure charge would be in the region of £250 per water connection and £250 per sewerage connection. As such a charge would be levied under Scottish Water's general charges scheme rather than these Regulations and it is not considered further in this consultation paper.

Previous Consultation

2.12 This consultation on detailed proposals for Regulations follows earlier consultations on the principles of paying for new connections to the water and sewerage networks. The consultation paper *Managing Change in the Water Industry: A Consultation Paper* (June 2000)² proposed that there should be a framework of charging for access to the public networks that was cost reflective, ensured that the network was soundly financed and reflected the other responsibilities placed on the water authorities. This issue arose again in the consultation paper *The Water Services Bill - The Executive's Proposals* (March 2001)³.

2.13 These led to the provisions in Part 2 of the Water Environment and Water Services (Scotland) Act 2003, which provide powers to make Regulations to determine reasonable cost.

2.14 As part of the preparation for Scottish Water's next regulatory period 2006-10, the Executive published two parallel consultation papers in July 2004. These examined the principles of charging for water services and the investment objectives that should be set for Scottish Water.

2.15 One of the principles discussed in *Paying for Water Services 2006-2010: A Consultation on the Principles of Charging for Water Services*⁴ was how to fund the

² *Managing Change in the Water Industry: A Consultation Paper*, Scottish Executive, June 2000

³ *The Water Services Bill - The Executive's Proposals*, Scottish Executive, March 2001

⁴ *Paying for Water Services 2006-2010: A Consultation on the Principles of Charging for Water Services*, Scottish Executive, July 2004 (<http://www.scotland.gov.uk/consultations/environment/pfws-00.asp>)

expansion of the public networks. It proposed that developers should be required to fund increased local capacity where that was necessary, and that Scottish Water, as well as covering existing infrastructure maintenance and renewal, should meet future strategic capacity needs. The consultation paper acknowledged that this would require developers to meet the costs of relieving local infrastructure constraints but considered that placing this cost on existing customers, alongside all the other investment requirements of the industry, would be unreasonable.

2.16 The majority of respondees to the *Paying for Water Services* consultation⁵ were in favour of developers meeting local infrastructure costs to overcome development constraints. Some respondees felt that developments which brought social or economic benefits, such as rural or public sector housing should receive more assistance, with costs being shared between the developer, the Scottish Executive and Scottish Water. Where a commercial development was speculative, there was support for the developer to be required to meet all local costs. Housing developers who responded commented that the current piecemeal approach to meeting the cost of increased capacity was unsatisfactory and unclear.

2.17 *Investing in Water Services 2006-2014: The Quality & Standards III Project: A Consultation Paper*⁶ was designed to gauge stakeholders' views on investment priorities for Scottish Water. Among the questions it posed was whether Scottish Water should fund new connections even where the costs of these exceeded 'reasonable cost'. Many respondees agreed in principle with this⁷, but there were concerns that this option would not represent value for money for Scottish Water's customers against other priorities, such as environmental considerations and removing constraints on new development. And those who did support such an objective were not in favour of it being funded through higher charges or lower investment elsewhere. Other respondees suggested either that a balance needed to be struck between the costs to Scottish Water and developers, that funding should come from the developers or other bodies who would directly benefit, or that additional investment should be provided by the Scottish Executive.

2.18 These consultations were supplemented by research commissioned by the Scottish Executive to gather wider information on both domestic and non-domestic customers' views on the issues raised in the consultation papers. This research has been published through *Paying for Water Services 2006-2010 Qualitative Research Project: Report of Findings* (February 2005)⁸ and *Investing in Water Services 2006-2014: Research into Customer Views: Report of Findings* (February 2005)⁹. In relation to charging, the research found that most participants considered it to be fair and logical for developers to fund those parts of additional local capacity that were required solely to enable their developments to proceed. Others suggested that the Scottish Executive should have a role in funding infrastructure for social

⁵ Responses to the consultation paper were published in *Paying For Water Services 2006-2010: Analysis Of Responses To The Scottish Executive Consultation: Final Report*, Environmental Resources Management Ltd/ Scottish Executive, February 2005 (<http://www.scotland.gov.uk/library5/environment/pwsacr-00.asp>)

⁶ *Investing in Water Services 2006-2014: The Quality & Standards III Project: A Consultation Paper*, Scottish Executive, July 2004 (<http://www.scotland.gov.uk/consultations/environment/iivs-00.asp>)

⁷ Responses to the consultation paper were published in *Quality and Standards III: Investing in Water Services 2006 - 2014: Analysis of Responses to the Scottish Executive Consultation*, Scottish Executive/Environmental Resources Management Ltd, February 2005 (<http://www.scotland.gov.uk/library5/environment/iwsarc-00.asp>)

⁸ *Paying for Water Services 2006-2010 Qualitative Research Project: Report of Findings*, Scottish Executive/mruk, February 2005 (<http://www.scotland.gov.uk/library5/environment/pwsqrr-00.asp>)

⁹ *Investing in Water Services 2006-2014: Research into Customer Views: Report of Findings*, Scottish Executive/MORI Scotland, February 2005 (<http://www.scotland.gov.uk/library5/environment/qs3rcv-00.asp>)

housing (as it does already through Communities Scotland) and other non-profit making development. In relation to investment, the research found that people were closely balanced between those who considered that the total cost of connection for new developments should fall to the developers (46%), and those who considered that these costs should be shared between Scottish Water and the developer (43%). When asked about extending the networks to allow existing properties to be connected, a majority of people (55%) considered costs should be shared between Scottish Water and the individual householders, as opposed to the householder or Scottish Water meeting all costs.

Construction standards and vesting conditions

2.19 Part 2 of the Water Environment and Water Services (Scotland) Act 2003 also amended the Sewerage (Scotland) Act 1968 and the Water (Scotland) Act 1980 to make provision for further Regulations, relating to:

- the construction standards which assets must meet to vest in Scottish Water; and
- the vesting or takeover conditions which might form the basis of an agreement for Scottish Water to take over an asset built by a developer.

2.20 These Regulations are still being developed and the Scottish Executive expects to consult on them soon.

3. Policy Principles

3.1 In February 2005, following the consultations and research studies mentioned above, the Deputy Minister for Environment and Rural Development made two statements to Parliament. These statements set out the principles by which Scottish Water was to charge for water and sewerage services in the period 2006-2010¹⁰, and the investment objectives Scottish Water should be funded to achieve in the period 2006-2014¹¹.

3.2 As part of these statements, the Minister set out policy principles to be delivered by the Reasonable Cost Regulations.

3.3 These set, as an investment objective for Scottish Water, that it should meet the strategic or deep infrastructure requirements of all anticipated new development during the period 2006-2014, and require the Water Industry Commission to fund Scottish Water to deliver this objective. The statements then committed Ministers to bringing forward Reasonable Cost Regulations to determine how Scottish Water and developers should contribute towards providing local infrastructure. The statements set out that the Regulations would provide for Scottish Water to make no net contribution to these connections, by limiting its contribution to a sum that would reflect the additional charge income that it would receive towards maintaining the asset base as a consequence of the infrastructure vesting in it. Developers would be responsible for meeting all costs for local infrastructure which were not funded by Scottish Water's contribution.

3.4 The statements also said that Ministers intended to limit Scottish Water's contribution to what is termed 'Part 3' infrastructure and require developers to fund completely 'Part 2' infrastructure. However, in developing the detailed Regulations it has become apparent that this is not a straightforward distinction to make and that such an approach would not recognise the additional charge income that Scottish Water will receive where only investment in 'Part 2' infrastructure is required. This consultation paper and the draft Regulations therefore propose that it would be clearer and more equitable to simply treat these two elements together as 'local infrastructure', and that these are the parts of a connection which Scottish Water is to consider in determining its duty to make a 'reasonable cost' contribution. This would mean Scottish Water's contribution to new connections was available towards the total costs of both local water mains and sewers, and trunk mains and sewers and all other 'Part 2' or 'Part 3' assets.

3.5 These principles provide a more transparent and equitable basis for funding new connections by sharing the costs of providing new local infrastructure between Scottish Water and developers. This approach is in line with the stakeholder and public views on this issue as expressed in recent consultations and research.

¹⁰ The principles to be applied in charging for public water and sewerage services in Scotland 2006-2010: Statement by the Scottish Executive, 9 February 2005, (<http://www.scotland.gov.uk/Topics/Environment/Water/17583/PrinciplesofCharging>)

¹¹ Investing in water services: Objectives for 2006-2014: The statement by the Scottish Executive, 9 February 2005 (<http://www.scotland.gov.uk/topics/environment/water/17583/investment>)

4. Detailed Policy Proposals

4.1 The draft Regulations, and the supporting documents that will accompany them, are intended to deliver the broad policy principles proposed in section 3. They will do this by:

- clarifying the point at which Scottish Water’s duty to provide a connection is engaged;
- defining what type of infrastructure Scottish Water’s reasonable cost contribution should be provided towards;
- providing a formula for calculating what that contribution should be; and
- requiring Scottish Water to either carry out work up to the value of the reasonable cost contribution or to reimburse a developer for work they have carried out, up to the same value and subject to the work meeting Scottish Water’s construction standards and vesting conditions, as specified in an agreement.

Infrastructure eligible for a contribution

4.2 The draft Regulations provide that Scottish Water’s reasonable cost contribution would be made towards the local infrastructure required to make a new water or sewerage connection (including first time provision to existing properties). This includes both the new assets, for example, a new water main, that are required, and also any work to existing assets, for example, to reinforce or enlarge a main or sewer to carry additional capacity. This would also include any costs associated with this work, such as design or inspection costs.

4.3 The draft Regulations exclude the costs associated with providing a service pipe or drain – these are the most immediate water and sewerage infrastructure, respectively, to a property, often mostly within its boundary, that are currently paid for by the developer. Under the draft Regulations, these remain the responsibility of the developer. The draft Regulations also exclude infrastructure that Scottish Water is required to provide through its main investment programme, which includes all strategic capacity, as well as any other work on its network, for example, to meet environmental objectives, that also assists with a connection. These are solely for Scottish Water to fund.

4.4 In developing this policy, we have considered what equivalent provision is made in other parts of the UK regarding new connections to the water and sewerage networks. In England and Wales, where the water industry is privatised, a similar arrangement to that proposed in the draft Regulations is in place. Under provisions in the Water Act 2003, new arrangements were brought into effect for developers wishing to connect to the water networks. Where developers decide to install the infrastructure for a water supply to a domestic property themselves, water companies are required to make an ‘asset payment’ in recognition of future income. This payment calculation is based on estimates of the revenue that will be received from newly connected properties. Different arrangements exist where developers choose to install sewerage infrastructure themselves. The sewerage company concerned is not required to pay developers an asset payment for self laid sewers, but neither are they able to recover a charge for network reinforcement required as a result of the sewerage connection. This provision reflects the different primary legislation in place in England and Wales regarding new sewerage connections.

4.5 Where the developer asks or ‘requisitions’ the English or Welsh water or sewerage company to lay new water or sewerage infrastructure for domestic purposes on their behalf, the company will charge for the work that it carries out. Some companies make a standard

charge for this work, others levy charges based on actual costs. The costs they may recover are set out in OFWAT's *Guidance on financial arrangements for self-lay and requisitioning agreements* (2004)¹², and reflect the costs reasonably incurred in carrying out the work, taking account of income the connections will generate, but excluding any allowance for profit. Again, this sum is based on the water or sewerage charges payable for the newly connected properties. Developers have the option of paying the relevant amount in 12 annual payments or as a single commuted payment.

4.6 The Executive's approach is to choose principles that are relatively consistent with those in England and Wales, where those are consistent with our primary legislation. This has the advantage that they have proved to work in practice, and will be understood by developers who operate on a UK basis.

Question 1: Do you agree that Scottish Water's contribution should be targeted at all local infrastructure ('Part 2' and 'Part 3'), with developers funding immediate connections and Scottish Water funding strategic capacity?

If not, what approach would you support, and why?

Non-domestic properties

4.7 The draft Regulations currently only apply to domestic properties. Given the diversity of non-domestic properties, and the slightly different duties on Scottish Water regarding connections to these properties, we are undecided as to whether there is a standard, equitable formula that could be applied to calculating reasonable cost contributions for non-domestic properties. In the absence of specific provision in the Regulations, Scottish Water would have to determine what contribution it should make to non-domestic connections on a case by case basis, as it does at present.

4.8 However, if a method could be determined which would provide a clear basis for calculating reasonable cost for non-domestic properties, that would have the advantage of ensuring that these connections were addressed transparently and equitably.

4.9 One possible approach would be to define an average charge income from a standard non-domestic property, and use that in a formula along the same lines as that for domestic properties. For example, for water connections, this average charge income might be based on a typical 20mm connection pipe (which would reflect over 80% of non-domestic water customers) and an annual average consumption. This standard approach could be adopted for the majority of cases. Other cases, such as those developments which could be expected to have much larger water consumption, could be dealt with by Scottish Water on a case by case basis, by making a more specific analysis.

4.10 An added variable might be to adjust Scottish Water's contribution to reflect the proportion of water and sewerage use in the property that is for 'domestic purposes' – e.g. sanitation and food preparation – and target the contribution at that, rather than any industrial or commercial process being undertaken. This might be achieved by calculating a rough 'population equivalent' for how many people use the premises. Or the best rule of thumb

¹² Guidance on financial arrangements for self-lay and requisitioning agreements, OFWAT, May 2004, ([http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/selflay_guidance_financial140504.pdf/\\$FILE/selflay_guidance_financial140504.pdf](http://www.ofwat.gov.uk/aptrix/ofwat/publish.nsf/AttachmentsByTitle/selflay_guidance_financial140504.pdf/$FILE/selflay_guidance_financial140504.pdf))

may simply be Scottish Water's current approach to sewerage connections where their contribution is based on the surface area covered by a development. We would welcome your views and suggestions.

Question 2: Should the Regulations define Scottish Water's contribution towards (a) domestic properties only, or (b) domestic and non-domestic properties?

Question 3: If the Regulations were to define reasonable cost for non-domestic properties, what method do you suggest should be used?

Calculating the contribution

4.11 It is proposed that Scottish Water can either make a reasonable cost contribution to a developer, who is carrying out the work required for a connection themselves, or that Scottish Water should carry out the work directly. In either case, Scottish Water's contribution will be limited to whichever is lower of the actual cost of the connection or the amount calculated under the Regulations as the maximum reasonable cost contribution for a water or sewerage connection.

4.12 We propose that the Regulations, or their supporting documents, will make clear that Scottish Water's contribution to a new connection is only due when the development is at an advanced stage. It is also likely that Scottish Water will provide guidance on calculating the costs involved, along the lines of the standard rates they currently publish for different types of work or materials. These measures will help ensure that Scottish Water's investment is only made towards costs that are necessarily incurred and when future charge income from the connection will clearly be forthcoming. This may require developers to bear these costs initially, however this would be a small cost relative to the others involved in a development and would be on the basis of clear agreements with Scottish Water which would guarantee Scottish Water's contribution when the development and connections were complete.

Question 4: Do you agree that Scottish Water's contribution should be limited to an amount based on future income from that connection and payable only when a development is well advanced?

If not, what approach would you support, and why?

4.13 The draft Regulations propose a formula to estimate the financial benefit that Scottish Water would receive from a new or reinforced asset and that the amount calculated according to the formula should be the maximum reasonable cost contribution Scottish Water is liable to make towards a new water or sewerage connection.

$$\text{Reasonable cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^n \right]$$

4.14 This formula takes into account the charge income (*A*) from a property, the number of years (*n* years) that an asset provides a benefit for, and the cost of borrowing money (*c*) to provide the contribution at the outset. Each of these factors is discussed below.

4.15 The formula provides for a calculation of the maximum reasonable cost contribution available for a single property. Since a reasonable cost contribution under the Regulations would be available for each separate domestic property in a development, where more than one property will be served by the new connection, the contribution can simply be multiplied by the number of properties (e.g. houses or flats) involved.

Charge income

4.16 Scottish Water's charge income from domestic properties is based on a sliding scale according to the council tax band of a property, so that those in higher banded properties pay more than those in lower banded properties. Instead of using the exact charge income for a particular property based on its council tax band, the draft Regulations propose to use an average water charge and an average sewerage charge for each water and sewerage connection respectively. This would lead to two simple levels of reasonable cost contribution for all domestic properties – a water contribution based on the average water charge, and a sewerage contribution based on the average sewerage charge. This approach avoids uncertainty regarding the eventual banding of a property and it removes any inequity in providing a larger contribution for higher banded properties, given that connection costs will not vary directly with council tax band. It also reflects the principle of harmonised water and sewerage charges across Scotland based on council tax bands. This system assists those who have least ability to pay, who might be expected to be the owners or buyers of the lowest banded properties.

4.17 The draft Regulations therefore use average water and sewerage charges, calculated as the mid-point between the band B and band C water or sewerage charge in the relevant year. This approximates the average council tax band in Scotland. The charges in that year will be used to forecast future income for the connection concerned, rather than making provision for this calculation to be revisited as charges increase or decrease, given that these cannot be predicted with certainty. This benefits both Scottish Water and the developer by allowing a single calculation to be made at the time of connection.

Financial benefit to Scottish Water

4.18 A way of calculating the financial benefit that a new connection brings to Scottish Water is to choose to allocate number of years' income to the cost of the connection. Once a new connection has been made, Scottish Water will receive a charge income from that connection for as long as the property concerned is occupied. The charge income that Scottish Water receives goes towards the operating costs of providing water and sewerage services, which it must meet for new customers in exactly the same way as for existing customers, and on capital costs of maintaining and investing in the public networks. Given that the new customer is served by a new asset at their expense, that should not require maintenance for a considerable period, the benefit that new customers bring to Scottish Water could be calculated as the proportion of their charge income that can go towards capital costs that they do not place on the network in the short term.

4.19 The power “*n*” in the formula reflects the number of years’ income which should be allocated to the asset. Thus if an asset can be expected to require no maintenance for 25 years, and approximately half the costs associated with serving a customer are related to infrastructure investment and half are ongoing operating costs, the financial benefit of a new connection could be estimated at around half the maintenance free period, or 12 years. This is the basis of the calculation made in England and Wales, and if transferred to Scotland would mean defining *n* as 12 years, in the formula provided in the Regulations. However, a higher or lower figure would be appropriate if less or more of Scottish Water’s income went on operating costs that are incurred when each new customer joins the public networks. For example, if two thirds of income went on variable, customer related costs, only a third of the income in 25 years should be allocated to a new connection, or the whole income for around 8 years. This would mean a significantly lower reasonable cost contribution. Ministers will take into account advice from the Water Industry Commission and the outcome of this consultation in setting *n* in the Regulations.

The cost of making a single payment

4.20 Finally, the formula needs to take account of the cost to Scottish Water of making its contribution towards a connection in advance of receiving charge income from the new customer, denoted as “*c*” in the formula. Scottish Water must borrow funds from Scottish Ministers to make reasonable cost payments, alongside the borrowing Scottish Water makes to fund its investment programme. This borrowing incurs costs to Scottish Water. It is matched by a benefit to the developer in receiving the contribution at the time of connection rather than paid back over a period of years. Therefore the Regulations need to take into account the ‘real’ cost of capital to Scottish Water (taking into account inflation). The Water Industry Commission’s current view is that this should be in the range of 2.1% to 4.25%. The final figure that will be used in the Regulations will be set in the Water Industry Commission’s final determination of Scottish Water’s charges for 2006-2010 when that is made in November 2005. Thereafter, the Water Industry Commission may revise this figure from time to time, and when this happens the Regulations will be amended to reflect such a change.

4.21 Taken together, these factors produce the formula set out in Regulations 3 and 4. Although complex, there are few variables in the formula, and once the Regulations have been made, supporting documents will clearly set out Scottish Water’s maximum water and sewerage contribution per premises, as soon as the relevant charges for each year become available.

4.22 A sample calculation is set out on the next page to demonstrate how the maximum reasonable cost contribution that Scottish Water would be liable for in respect of a single water connection could be calculated. It is based on Scottish Water’s 2005-06 charges.

Example

$$\text{Reasonable cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^n \right]$$

First, each variable needs to be defined.

A is the average water charge for the year of connection. It is defined as the average of the Band B water charge (*X*, which is £126.98 for 2005-06), and the Band C water charge (*Y*, which is £145.12 for 2005-06), and calculated by adding these together and dividing by 2.

$$A = \frac{X + Y}{2} \quad A = \frac{126.98 + 145.12}{2} \quad A = \mathbf{£136.05}$$

c is the real cost of capital to Scottish Water. This example assumes that this is set at 4.25%. Therefore in the formula, *c* = **0.0425**.

n is the number of years income to be allocated to a new connection. This example assumes that this is set at 12 years. Therefore in the formula, *n* = **12**

Next, each variable needs to be inserted into the formula, and the calculation made.

$$\text{Reasonable cost} = \frac{136.05}{0.0425} \left[1 - \left(\frac{1}{1+0.0425} \right)^{12} \right] = 3,201 \times \left[1 - \left(\frac{1}{1+0.0425} \right)^{12} \right]$$

$$\text{Reasonable cost} = 3,201 \times 0.393$$

$$\text{Reasonable cost} = \mathbf{£1,258}$$

Based on these variables, Scottish Water's maximum reasonable cost contribution to a new water connection to a single property would be £1,258. A similar calculation can be made for the maximum contribution towards a single new sewerage connection, which comes out as £1,422.

4.23 If a lower cost of capital “*c*” were used, Scottish Water’s contribution would be higher. On the other hand, if the calculation was done over a fewer number of “*n*” years, Scottish Water’s contribution would be lower.

Question 5: Do you have any comments on the proposed basis for calculating Scottish Water’s reasonable cost contribution?

Question 6: What factors should be taken into account in setting the variables *n* and *c*, and why?

First Time Connections

4.24 The draft Regulations make no distinction between connections to new properties and connections to existing properties, in the same way that Scottish Water is subject to the same duty regarding all properties seeking a new connection to the water or sewerage networks.

This means that those seeking what is known as a ‘first time’ connection, to premises that are currently served by a private water supply or sewerage system, would receive the same reasonable cost contribution as those connecting new properties. This seems equitable, given that no difference is made between charges to new or existing properties once they are connected to the public water or sewerage networks.

4.25 Historically, such connections have sometimes been treated differently by Scottish Water or the previous water authorities. Scottish Water’s current policy has been to make the same £500 contribution towards water connections to existing properties as it does for new properties, and a contribution of between £2,000 and £6,000 towards new sewerage connections to existing properties (ranging from around £2,000 for a council tax band A property, to around £6,000 for a band H property). The draft Regulations would mean that contributions to the connection of existing properties are the same as those to new properties. Using the values of *n* and *c* set out in the draft Regulations, this would mean contributions towards first time connections of between £1,200-£1,400, depending on whether a water or sewerage connection was involved and on the relevant annual water and sewerage charges.

4.26 This reflects Scottish Water’s investment objectives, as set out in the Ministerial statement in February 2005, which did not make any provision for first time water or sewerage connections, except that which was included as part of the main drinking water or environmental programmes for 2006-2014. Further assistance might be available to the current users of private water supplies through the Private Water Supplies Grant Regulations which the Scottish Executive is due to make later in 2005 and which will assist users in improving their water supply to meet modern standards. It will be possible to use this grant to meet the costs of connecting the property to the public water supply, and this would be available in addition to Scottish Water’s reasonable cost contribution.

4.27 These proposals will reduce the contribution currently made towards new sewerage connections for existing properties. However, we believe that those contribution levels have meant that Scottish Water’s customers contributed to such connections at a level that could never be recouped from such connections. Continuing this practice would be contrary to the principle that Scottish Water should contribute to these connections where that is justified by future income, and places an inappropriate burden on other customers.

Question 7: Do you agree that connections for new properties and existing properties should be treated equally?

If not, what approach would you support, and why?

Appeals

4.28 The Sewerage (Scotland) Act 1968 and the Water (Scotland) Act 1980 both make provision for an appeal (a “question”) to be made against Scottish Water’s proposals for provision of sewerage or water infrastructure and Scottish Water’s determination of reasonable cost. These powers were amended by section 23 of the Water Services etc. (Scotland) Act 2005 to provide that appeals should be made to the Water Industry Commission for Scotland instead of Scottish Ministers, as the body best placed to assess Scottish Water’s actions in this regard. An appeal regarding reasonable cost can relate to whether Scottish Water has properly determined this contribution in accordance with the

proposed Regulations (rather than providing an opportunity to challenge the principles that the Regulations are based on).

4.29 The Water Industry Commission is required to make a statement setting out the procedure it will follow in considering any appeals of this type. We would expect the Commission to prepare this statement and consult on it when the Regulations have been finalised in early 2006. Once the Water Industry Commission has made a decision on an appeal, Scottish Water is required to give effect to the Commission's decision.

Guidance and supporting documents

4.30 A key aim of these proposals is to provide clarity and certainty for Scottish Water, and developers regarding their rights, responsibilities and how the process of connecting to Scottish Water's networks operates. The draft Regulations will be an important part of this, but they cannot cover all aspects of connections. For example, guidance or other binding measures will provide for Scottish Water's contribution to connections where the cost exceeds the maximum reasonable cost contribution as calculated under the Regulations. Our intention is that in these cases, Scottish Water should contribute the maximum contribution that it would be liable to contribute if the Regulations applied to such a connection, where an agreement is in place to ensure that the infrastructure is constructed and the costs properly incurred, and that the developer (or householder) has agreed to meet the excess costs.

4.31 Scottish Water and the Water Industry Commission both recognise the importance of providing clear guidance to underpin the principles established in the Regulations and supporting documents, and to assist in their implementation. This guidance will cover practical issues that are unsuitable for inclusion in the Regulations, for example, describing the process by which applications for new connections can be made, including timescales, procedures and charges. This will be developed alongside the final Regulations, in early 2006.

5. Related Issues

Development Constraints

5.1 A key issue that arose during consideration of Scottish Water's next investment programme was that of development constraints, where a lack of capacity in water and, in particular, sewerage infrastructure was preventing or delaying new developments from being connected to the public networks. In the current investment programme, which ends on 31 March 2006, no specific objective was established for new development. However, in the forthcoming investment period, Scottish Water has been set an investment objective for the period 2006-2014 to meet the strategic capacity requirements of all anticipated new development. This means that Scottish Water will be funded to ensure that there are no constraints in this type of infrastructure.

5.2 In creating a clear, unambiguous and funded objective for Scottish Water to provide for strategic capacity, Ministers have stated that they expect Scottish Water to achieve a "significant improvement in the planning and delivery of new strategic capacity in the public system". Successful delivery of this goal will require Scottish Water to improve the quality of data it holds about the capacity of the system; to work more closely together with SEPA in order that, where possible, drainage capacity is maximised; and to take forward effective and genuine discussions with local authorities on their development priorities, within the context of the National Planning Framework.

5.3 While some development constraints relate to strategic assets which hence forth will be funded by Scottish Water, some relate to the assets which are part of 'local infrastructure' for which a reasonable cost contribution is available, for example, trunk sewers or wastewater pumping stations where either a new asset is required or an existing asset needs to be reinforced or enlarged to carry more capacity. The draft Regulations and the documents that will support them will provide clarity that where costs in this type of infrastructure arise and they exceed the amount that Scottish Water will contribute, the excess costs must be met by the developer. In many cases, developers are already meeting or offering to meet these costs to allow their development to proceed. The draft Regulations and guidance will formalise that position and provide certainty as to the responsibilities on developers and Scottish Water. Provision will be made to Communities Scotland to cover the impact of this policy on affordable housing developments. This is in addition to the benefits which will accrue to these developments from the above reasonable cost arrangements.

Question 8: Do you have any comments on the implications of the draft Regulations on development constraints?

Reserving capacity

5.4 Private investment in the water and sewerage networks to allow particular developments to proceed has led to demands that investors should be able to pay for more capacity than they require immediately and reserve that capacity for their own use. For example, this might arise when a development is planned over a number of years, or when a substantial new asset is required which would have, for little or no further investment, capacity beyond that required for the initial development.

5.5 However, this needs to be considered against Scottish Water's general duty to make connections where that is practicable at reasonable cost, for example, when faced with a subsequent request from a different developer. This type of reservation to achieve substantially delayed connection and prevent other developers from being able to make connections may undermine the public nature of Scottish Water's assets. A balance is required between developers being able to finance the resolution of a local constraint (when costs exceed Scottish Water's reasonable cost contributions), and allowing developers to speculatively invest in the public networks, possibly to the disadvantage of other developers and the public interest.

5.6 Given Scottish Water's investment objective to address all strategic capacity requirements in the period 2006-2014, this issue is likely to become less pressing in relation to strategic assets, for example, water and wastewater treatment works. However, demands to reserve capacity may still arise in relation to local infrastructure assets.

5.7 It will be important that the guidance that supports these Regulations sets out Scottish Water's procedures on connections, and that clear protocols are established which will ensure that developers' investment in an asset is protected for a reasonable, short term, period. For example, that might involve a developer receiving a formal connection quotation from Scottish Water, with a clear timescale on how long the quotation is available for and when it would be made. Once such a quotation had been accepted, Scottish Water could 'hold' the capacity for a period, say one year. If no use was made of the capacity by the end of the period it would then be available to others (including the original developer).

5.8 It is not clear the extent to which provision to protect longer term agreements for local infrastructure assets is desirable or necessary. Further, should such arrangements be sought, it is not clear that any benefit the developers would secure would offset the disadvantage to others in terms of tying up scarce resources and capacity needlessly, and requiring Scottish Water to operate assets without the benefit of its full charge income. Instead, it may be in everyone's interests for a phased approach to water and sewerage provision to be made in developments that span a substantial period.

Question 9: What, if any, provision on reserving capacity would you support and why?

6. Commentary on Draft Regulations

6.1 This section is intended to be read alongside the text of the draft Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2006, which are set out in the following section (Section 7). Below, each regulation (the numbered sections in the draft Regulations) is considered in turn, with a commentary on how and why a particular approach has been taken and what it means.

Your views are sought on the draft Regulations. The previous sections of this paper picked out what we believe to be the key policy questions, but general or specific comments on the Regulations themselves are also invited.

Regulation 1: Citation and interpretation

6.2 Regulation 1 provides for the Regulations to come into force on 1 April 2006. It also provides definitions of certain terms used in the Regulations, which underpin the provisions in the subsequent Regulations. Most of these definitions make reference to those already given in other Acts:

- Section 29A of the Water Industry (Scotland) Act 2002 (“the 2002 Act”) provides that a “charges scheme” fixes the charges to be paid for services provided by Scottish Water in the exercise of its core functions, and that it is to be drawn up by Scottish Water and approved by the Water Industry Commission. Scottish Water's core functions are defined at section 70(2) of the 2002 Act and for all practical purposes the definition includes all activities involved in providing statutory public water and sewerage services.
- Section 72 of the Local Government Finance Act 1992 defines “dwelling” for the purpose of liability for council tax in Scotland. Using this definition provides that connections of all premises that are classed as dwellings for council tax purposes are eligible for a reasonable cost contribution under the draft Regulations.
- Sections 28 and 29 of the Water Services etc. (Scotland) Act 2005 (“the 2005 Act”) set out the meanings of the terms “public water supply system” and “public sewerage system” respectively. The “public water supply system” is defined as all mains, pipes, water treatment works and other similar infrastructure vested in Scottish Water (i.e. infrastructure for which Scottish Water is responsible), or used by Scottish Water (or a person acting on its behalf or under its authority, such as a PFI contractor) in connection with the exercise of Scottish Water's core functions in respect of the public water supply. The “public sewerage system” is defined as all sewers, drains, sustainable urban drainage systems (SUDS), sewage treatment works or other similar infrastructure vested in Scottish Water or used by Scottish Water (or a person acting on its behalf or under its authority, such as a PFI contractor) in connection with the exercise of Scottish Water's core functions in respect of statutory public sewerage services.

6.3 The terms “sewerage charges” and “water charges” are defined in Regulation 1, as the charges payable under a charges scheme in respect of the provision of, respectively, sewerage or the disposal of sewage, and a supply of water, to a dwelling.

6.4 The draft Regulations are underpinned by the definitions set out in Regulation 1.

Regulation 2: Application of the Regulations

6.5 Regulation 2 determines when the Regulations apply and in respect of which properties.

6.6 Regulations 2(1) and (2) provide that the Regulations only apply to connections of domestic premises (dwellings) to the public water and sewerage networks. As discussed in section 4 of this paper (paragraphs 4.7 to 4.10), the draft Regulations do not apply to non-domestic properties. We are consulting on whether non-domestic properties should be included in the final Regulations, and on what basis.

6.7 Regulation 2(3) specifies which parts of a connection the Regulations do *not* apply to, and towards which a reasonable cost contribution calculated under the Regulations is therefore not available. This includes the construction of a drain or service pipe, sometimes termed ‘Part 1’ infrastructure. These are the pipes between a property and its immediate connection with a sewer or water main, usually close to the property boundary, and are defined in the Sewerage (Scotland) Act 1968 and the Water (Scotland) Act 1980 respectively. Any element of a connection that Scottish Water is required to make in compliance with any direction given under sections 56 and 56A of the 2002 Act is also excluded from the Regulations. This is the provision under which Scottish Water’s investment objectives are set by Scottish Ministers. It therefore excludes from these Regulations the cost of Scottish Water complying with the objectives Ministers have set for the period 2006-2014, including the requirement that Scottish Water must meet the strategic capacity requirements of all anticipated new development, that is to say, the ‘Part 4’ infrastructure required for new connections. It also applies to all work which is defined as part of the drinking water quality or environment programmes.

Regulations 3 and 4: Calculation of Reasonable Cost

6.8 Regulations 3 and 4 set out equivalent provision to calculate the maximum contribution that Scottish Water would be liable to make under these Regulations for sewerage connections and water connections respectively. They do this by means of a formula which calculates the financial benefit of a new connection to Scottish Water.

$$\text{Reasonable cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^n \right]$$

6.9 The formula and the variables in it are described in detail in section 4 of the consultation paper (paragraphs 4.13 to 4.23). Regulations 3(1) and 4(1) define the maximum contribution for a connection of a single dwelling. Regulations 3(2) and 4(2) provide that where a connection serves more than one dwelling, Scottish Water’s maximum contribution is the amount calculated for a single dwelling multiplied by the number of dwellings served by the connection.

Regulations 5 and 6: Matters to be included in or excluded from the calculation of reasonable cost

6.10 Regulations 5 and 6 set out equivalent provision regarding the matters which should or should not be taken into account for the purpose of the Regulations in calculating the estimated cost of sewerage connections and water connections, respectively.

6.11 The costs which are to be included are those which are *reasonably and necessarily* incurred in making the connection and providing such infrastructure that Scottish Water considers necessary in consequence of the connection. For example, if Scottish Water considers that reinforcement work is required on an asset like a trunk sewer as a consequence of the connection of a particular development, the costs of that should be taken into account. This provision would cover not only the actual materials required, but all the associated work involved in its construction, for example, design or inspection costs. Scottish Water currently sets out a standard schedule for some of the costs involved in new connections where it carries out the work and we would expect this to be updated and expanded to accompany the Regulations.

6.12 The costs which are to be excluded from the calculation are the matters which Regulation 2(3)(a) and (b) provides that the Regulations do not apply to. These are any work on the immediate connection of a property ('Part 1' infrastructure) to the local mains or sewer and any work required of Scottish Water under their investment objectives (e.g. strategic capacity or 'Part 4' infrastructure), as well as any work relating to any of those two matters.

6.13 Taken together, these inclusions and exclusions mean that the costs to be taken into account in calculating the costs of a water or sewerage connection which are eligible for a reasonable cost contribution are those of the local infrastructure ('Part 2' and 'Part 3') which will serve the connection.

Regulations 7 and 8: Provision of a Connection

6.14 Draft regulations 7 and 8 are provided for the purpose of demonstrating what the proposed outcome of the policy as regards a connection being made under these Regulations. These make provision for Scottish Water to deliver the connection itself, or for the developer to enter into an agreement with Scottish Water to deliver the connection themselves. However, it is not yet decided whether this is the most appropriate way to deliver this part of our policy: alternative approaches, which would allow the provisions to be supported by more explanatory material, would include guidance or possibly a direction to Scottish Water. This might have the advantage of allowing them to appear alongside provision for Scottish Water's contributions where the actual cost of a connection exceeds the maximum reasonable cost calculated under the Regulations. Comments are invited on the principles set out in the draft regulations, on the basis that their final form may be revised.

6.15 Regulations 7 and 8 provide that where the cost of a connection is less than or equal to the reasonable cost level calculated under regulations 3 or 4, a developer can either enter into an agreement to provide the infrastructure themselves, or Scottish Water should provide it. Regulations 7(1) and 8(1) provide that where the developer chooses to make the connection, this will require them to enter into an agreement with Scottish Water and this will set out, among other requirements, provision for when Scottish Water is to pay to the developer its contribution towards the connection. Regulations 7(2) and 8(2) provide that where Scottish Water is to provide the connection, the developer is to initially meet the costs involved and Scottish Water is to reimburse the developer's contribution upon completion of the connection.

7. Draft Regulations

SCOTTISH STATUTORY INSTRUMENTS

2006 No.

WATER SUPPLY

The Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2006

<i>Made</i>	- - - -	2006
<i>Laid before the Scottish Parliament</i>		2006
<i>Coming into force</i>	- -	1st April 2006

The Scottish Ministers, in exercise of the powers conferred on them by section 1(3C) of the Sewerage (Scotland) Act 1968(a) and section 6(2D) of the Water (Scotland) Act 1980(b) and of all other powers enabling them in that behalf, hereby make the following Regulations:

Citation and interpretation

1.—(1) These Regulations may be cited as the Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2006 and shall come into force on 1st April 2006.

(2) In these Regulations—

“the 1968 Act” means the Sewerage (Scotland) Act 1968;

“the 1980 Act” means the Water (Scotland) Act 1980;

“the 2002 Act” means the Water Industry (Scotland) Act 2002 (c);

“the 2005 Act” means the Water Services etc. (Scotland) Act 2005(d);

“charges scheme” means any charges scheme made under section 29A of the 2002 Act(e);

“dwelling” means any dwelling within the meaning of Part II (council tax: Scotland) of the Local Government Finance Act 1992(f);

“public water supply system” is to be construed by reference to section 28 of the 2005 Act;

“public sewerage system” is to be construed by reference to section 29 of the 2005 Act;

“sewerage charges” means the charges payable under a charges scheme in respect of the provision of sewerage to, or the disposal of sewerage from, a dwelling; and

(a) 1968 c.47. Section 1(3C) was inserted by section 29 of the Water Environment and Water Services (Scotland) Act 2003 (asp 3).

(b) 1980 c.45. Section 6(2D) was inserted by section 29 of the Water Environment and Water Services (Scotland) Act 2003 (asp 3).

(c) 2002 (asp 3).

(d) 2005 (asp 3).

(e) Section 29A was inserted by section 21 of the Water Services etc. (Scotland) Act 2005 (asp 3).

(f) 1992 (c.14), as amended by S.I. 1993/526 and S.I. 1997/673, regulation 2.

“water charges” means the charges payable under a charges scheme in respect of the provision of a supply of water to a dwelling.

(3) Other expressions used in these Regulations have the same meaning in these Regulations as they have in the 1968 Act and the 1980 Act.

Application of the Regulations

2.—(1) For the purposes of section 1(3) of the 1968 Act, so far as relating to section 1(2)(a) of that Act (duty of Scottish Water to provide for sewerage of their area), the reasonable cost of a connection to the public sewerage system in respect of a dwelling shall be calculated in accordance with regulation 3.

(2) For the purposes of section 6(1) and (2) of the 1980 Act (duty of Scottish Water to provide supply), the reasonable cost of a connection to the public water supply system in respect of a dwelling shall be calculated in accordance with regulation 4.

(3) These Regulations do not apply to—

(a) in relation to paragraph (1)—

- (i) a connection of a dwelling to the public sewerage system involving only the construction of a drain; and
- (ii) any element of a connection Scottish Water requires to make in compliance with any directions given to it under section 56 of the Water Industry (Scotland) Act 2002(g) so far as setting objectives of a type referred to in section 56A of that Act;

(b) in relation to paragraph (2)—

- (i) a connection of a dwelling to the public water supply system involving only the construction of a service pipe; and
- (ii) any element of a connection Scottish Water requires to make in compliance with any directions given to it under section 56 of the Water Industry (Scotland) Act 2002(h) so far as setting objectives of a type referred to in section 56A of that Act.

Calculation of Reasonable Cost: the 1968 Act

3.—(1) The reasonable cost of a connection to the public sewerage system shall be the cost as calculated in accordance with the following formula—

$$\text{£ reasonable cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^n \right]$$

Where—

“A” is the average of sewerage charges for a dwelling as calculated in accordance with the following formula—

$$A = \frac{X + Y}{2}$$

Where—

“X” is the amount specified in a charges scheme in respect of sewerage charges payable in respect of a Band B dwelling for the financial year in which the reasonable cost amount is payable; and

“Y” is the amount specified in a charges scheme in respect of sewerage charges payable for a Band C dwelling for the financial year in which the reasonable cost amount is payable;

(g) 2002 asp 3.

(h) 2002 asp 3; Section 56A was inserted by section 22 of the Water Services etc. (Scotland) Act 2005 (asp 3).

“c” is [4.25%], which represents the real cost of capital currently set by the Water Industry Commission for this purpose; and

“n” is [12], which comprises the number of years income to be allocated to the connection for the purposes of calculating reasonable cost.

(2) Where a connection to the public sewerage system will serve more than one dwelling, the reasonable cost of such a connection calculated in accordance with the formula referred to in paragraph (1) shall be multiplied by the number of dwellings to be served by the connection; and that amount shall comprise the reasonable cost for that connection.

Calculation of Reasonable Cost: the 1980 Act

4.—(1) The reasonable cost of a connection to the public water supply system shall be the cost as calculated in accordance with the following formula—

Where—

$$\text{£ reasonable cost} = \frac{A}{c} \left[1 - \left(\frac{1}{1+c} \right)^n \right]$$

“A” is the average of water charges calculated in accordance with the following formula—

$$A = \frac{X + Y}{2}$$

Where—

“X” is the amount specified in a charges scheme in respect of water charges payable in respect of a Band B dwelling for the financial year in which the reasonable cost amount is payable;

“Y” is the amount specified in a charges scheme in respect of water charges payable in respect of a Band C dwelling for the financial year in which the reasonable cost amount is payable;

“c” is [4.25%], which represents the real cost of capital currently set by the Water Industry Commission for this purpose; and

“n” is [12], which comprises the number of years income to be allocated to the connection for the purposes of calculating reasonable cost.

(2) Where a connection to the public water supply system will serve more than one dwelling, the reasonable cost of such a connection calculated in accordance with the formula referred to in paragraph (1), shall be multiplied by the number of dwellings to be served by the connection; and that amount shall comprise the reasonable cost for that connection.

Matters to be included in or excluded from the calculation of the cost of a connection: the 1968 Act

5.—(1) Subject to paragraph (2), when calculating the cost of a connection to the public sewerage system, account shall be taken only of the costs reasonably and necessarily incurred in making the connection, including—

- (a) the costs of the provision of such other infrastructure as is considered by Scottish Water to be reasonable and necessary to provide in consequence of the connection; and
- (b) such other costs as are considered by Scottish Water to be reasonably and necessarily incurred in consequence of the connection.

(2) No account shall be taken of—

- (a) any part or parts of a connection that relate to the matters referred to in regulation 2(3)(a); and

- (b) any charge which is payable under a charges scheme in respect of the making of a connection to the public sewerage system.

Matters to be included in or excluded from the calculation of the cost of a connection: the 1980 Act

6.—(1) Subject to paragraph (2), when calculating the cost of a connection to the public water supply system, account shall be taken only of the costs reasonably and necessarily incurred in making the connection, including—

- (a) the costs of the provision of such other infrastructure as is considered by Scottish Water to be reasonable and necessary to provide in consequence of the connection; and
- (b) such other costs as are considered by Scottish Water to be reasonable and necessarily incurred in consequence of the connection.

(2) No account shall be taken of—

- (a) any part or parts of a connection that relate to the matters referred to in regulation 2(3)(b); and
- (b) any charge which is payable under a charges scheme in respect of the making of a connection to the public water supply system.

Draft regulations 7 and 8 are provided for the purpose of demonstrating what the proposed outcome of the policy as regards the provision of a connection which can be provided at reasonable cost may be. It is not yet decided what form the policy may be delivered through – either in the Regulations, or by other administrative or binding measures.

[Provision of a Connection: 1968 Act

7.—(1) Where the reasonable cost of a connection to the public sewerage system calculated in accordance with regulation 3 is more than or equal to the estimated cost of such a connection calculated in accordance with regulation 5—

- (a) in the case where the person who requires the connection wishes themselves to make the connection, or any part thereof, Scottish Water shall pay to that person—
 - (i) the amount which comprises the reasonable cost; or
 - (ii) the amount that represents the estimated cost of the connection, if less

in accordance with an agreement entered into in terms of section 8 of the 1968 Act; and

- (b) subject to paragraph (2), in any other case Scottish Water shall provide the connection.

(2) In relation to a connection in respect of which paragraph (1)(b) applies, before Scottish Water provides the connection, the person requesting the connection shall pay to Scottish Water the estimated cost of the connection calculated in accordance with regulation 5; and upon completion of the connection, Scottish Water shall pay to that person—

- (a) the amount which comprises the reasonable cost, calculated in accordance with regulation 3; or
- (b) the amount that represents the estimated cost of the connection, if less

all in accordance with an agreement entered into in terms of section 8 of the 1968 Act.

Provision of a Connection: 1980 Act

8.—(1) Where the reasonable cost of a connection to the public water supply system calculated in accordance with regulation 4 is less than or equal to the estimated cost of such a connection calculated in accordance with regulation 6—

- (a) in the case where the person who requires the connection wishes themselves to make the connection, or any part thereof, Scottish Water shall pay to that person—
 - (i) the amount that comprises the reasonable cost; or

- (ii) the amount that represents the estimated cost of the connection, if less,
all in accordance with an agreement entered into in terms of section 23A of the 1980 Act; and
- (b) subject to paragraph (2), in any other case Scottish Water shall provide the connection.

(2) In relation to a connection in respect of which paragraph (1)(b) applies, before Scottish Water provides the connection, the person requesting the connection shall pay to Scottish Water the estimated cost of the connection calculated in accordance with regulation 6; and upon completion of the connection, Scottish Water shall pay to that person—

- (a) the amount which comprises the reasonable cost, calculated in accordance with regulation 4; or
- (b) the amount that represents the estimated cost of the connection, if less.]

[A member of the Scottish Executive]

St Andrew's House,
Edinburgh
2006

8. Partial Regulatory Impact Assessment

The Draft Provision of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2006

Purpose and intended effect of measure

(i) The Objective

1. The objective of the Regulations is to establish a statutory basis for the calculation of “reasonable cost” for the purposes of new connections for domestic premises, under the Sewerage (Scotland) Act 1968 (the 1968 Act) and the Water (Scotland) Act 1980 (the 1980 Act), as amended by the Water Environment and Water Services (Scotland) Act 2003. By clearly defining “reasonable cost” and connecting it to the income Scottish Water receives from a connection, the Regulations will provide a level and transparent basis for funding future connections to the water and sewerage networks.

(ii) The Background

2. Scottish Water has a duty to make new connections to its water and sewerage networks under the 1968 and 1980 Acts, where this can be done at “reasonable cost”. However there is currently no legally prescribed method for calculating what this “reasonable cost” limit is. Scottish Water’s existing policy for connections to domestic properties is to make a contribution or undertake work up to an arbitrary maximum of £500 per new water connection and £1,000 per new sewerage connection. For non-domestic properties, Scottish Water currently provides a connection allowance for sewerage services only of £23,600 per hectare of land connected. Where connection costs are less than these limits, Scottish Water only pay, or meet the actual costs incurred. Therefore Scottish Water’s current level of contribution is not determined on a clear economic basis and can result in them having to incur costs without any monetary return, for example, if the development does not go ahead, or is less extensive than originally envisaged, and with no guarantee that the charges income will recoup this initial outlay. Scottish Water currently makes different provision for ‘first time connections’ (existing properties currently served by a private water supply or sewerage system, e.g. a septic tank) to the sewerage network, with contributions ranging from around £2,000 for a council tax band A property, to around £6,000 for a band H property.

3. The Water Environment and Water Services (Scotland) Act 2003 made provision to regulate Scottish Water’s contribution towards new connections to its networks, to bring clarity to this issue and ensure that contributions are made on a clear economic basis. During the passage of this Act, Scottish Ministers committed to consulting on these Regulations in draft and producing a Regulatory Impact Assessment setting out the costs and benefits of introducing the draft Regulations.

4. The draft Regulations propose a formula to calculate the reasonable cost contribution based on the future charge income from a connection. Detailed information on the formula is set out in the accompanying consultation paper. The Scottish Executive also proposes to allow Scottish Water to introduce a charge for new connections, similar to other utility connection charges, including water and sewerage connections in England and Wales. This would be in the region of £250 per water connection and £250 per sewerage connection. It

would be made under Scottish Water's general charges scheme rather than these Regulations and is therefore not subject to this Regulatory Impact Assessment.

5. In July 2004, the Scottish Executive published a consultation paper, *Paying for Water Services 2006-2010*, which sought views on the principles of charging for water (and sewerage) services. One of the principles examined was funding the expansion of the public networks, where the consultation proposed that developers should be required to fund increased local capacity where that was necessary, and Scottish Water, through its customer base, should fund maintenance and renewal of existing infrastructure and meet future requirements for strategic capacity.

6. That consultation paper proposed a principle that developers should be required to meet a greater share of the costs of providing local capacity for connections to help overcome development constraints. 44% of respondents were in favour of such proposals, with 8% against and the remainder having varying views: for some types of development and in some locations, or where the development brought social or economic benefits, they felt that the costs should be shared between the developer, the Scottish Executive and Scottish Water. Where a commercial development was speculative, there was support for a developer being required to meet all local costs. A number of the housing developers who responded commented that the current piecemeal approach to meeting the cost of increased capacity, without clear guidelines and responsibilities, was unsatisfactory.

7. Research carried out for the Scottish Executive to supplement this consultation process also indicated widespread support for developers to pay for additional capacity required by their development, as this was deemed to be fair and logical. However, again, there was some support for the Scottish Executive funding infrastructure for social housing and other non-profit making developments. The Scottish Executive already has such a role through its agency, Communities Scotland. The impact of the Regulations on Communities Scotland's expenditure has already been discussed with the agency and they have been consulted on this Regulatory Impact Assessment.

8. That consultation process led to a Ministerial Statement in February 2005 on the principles of charging which would apply to Scottish Water's charges for the period 2006-10. This included a requirement for Scottish Water to meet the strategic capacity requirements of all anticipated new development over this period, and this is reflected in the draft Regulations. The Statement also said that the Regulations would establish how developers and Scottish Water would be required to contribute towards the costs of providing local infrastructure. The Statement went on to say that Ministers' intention was that developers should meet all "Part 2"¹ costs and that Scottish Water would contribute towards "Part 3" costs. This has now been reconsidered and the draft Regulations, and Option 3 of this Regulatory Impact Assessment, treat Parts 2 and 3 collectively as "local infrastructure" and provide that Scottish Water will make a contribution towards all Part 2 and 3 costs, and require developers to meet any costs in excess of this contribution. The Statement also indicated that Scottish Water's contribution would be limited to a sum which reflected the additional charge income that it would receive as a consequence of the new infrastructure.

¹ The terms Part 2 and Part 3 are defined, and this policy change discussed further, on pages 7 and 10, respectively, of this paper in the attached consultation paper.

9. In parallel with the *Paying for Water Services* consultation, the Scottish Executive consulted on the investment objectives Scottish Water should be set through the consultation paper *Investing in Water Services 2006-2014*. It sought views on how to fund the strategic capacity in the water and sewerage networks, the deepest elements of connections, and whether Scottish Water's investment programme should include funding for new connections where these exceeded "reasonable cost". Many respondents agreed in principle that Scottish Water should fund all new connections (45% agreeing, with 36% offering alternative suggestions). However, this was accompanied by concerns that this option would not represent value for money for customers, and that it was a lower priority than other objectives, such as removing development constraints and environmental measures. These concerns were reflected in views as to how to fund such an objective, where only 26% thought it should be funded through higher charges and 4% through lower investment elsewhere. On the other hand, research on the same issue found that 46% of people felt that connections required for new housing should be funded by developers, who would pass costs onto the new residents, 43% believed that costs should be shared between Scottish Water and developers and 4% thought that Scottish Water should bear all the costs.

10. This consultation led to a parallel Ministerial Statement, which set Scottish Water's investment objectives for the period 2006-2014. This required Scottish Water to meet the strategic capacity requirements of all anticipated new development; and provided that the cost of additional local capacity should be met by the developer. This reflected the decision in the statement on charging policy to limit Scottish Water's contribution to local capacity to the income that would be derived from the new connection.

11. Another issue that arises in relation to new connections to the public networks is whether different provision should be made in relation to 'first time connections', for existing properties currently served by a private water supply or sewage treatment facility. The issue of first time connections was discussed in the *Investing in Water Services* consultation paper, which noted that investment in these could be justified in terms of improving water quality, public health, and the water environment. The consultation paper set out the very substantial costs of making first time connections one of Scottish Water's investment objectives. Ministers concluded that investment in this area should be focused on the priority wastewater schemes SEPA had identified as required to bring about environmental improvements and compliance with European Directives, then costed at £260 million. Other first time connections would be eligible for a reasonable cost contribution.

12. Scottish Water has the same legal duty to make a reasonable cost contribution for both first time connections and connections to developments and the draft Regulations propose that the same level of contribution should be available whether a new or existing property is involved. This seems the fairest approach, given that Scottish Water does not receive a different level of income from a first time connection. Scottish Water's current policy, based on an approach taken by the previous water authorities, of offering a considerably greater contribution towards first time sewerage connections has meant Scottish Water making contributions which were unlikely to ever be recouped through charges.

(iii) Rationale for Government Intervention

13. Provision to determine reasonable cost through Regulations was made in 2003, under Part 2 of the Water Environment and Water Services (Scotland) Act 2003. The Financial Memorandum which accompanied Parliamentary consideration of the Act explained

Ministers' intention to alter the division of the costs of funding new infrastructure in the water industry between Scottish Water and developers, to replace Scottish Water's fixed contributions with a contribution based on an objective cost benefit analysis. It also set out a commitment to consult on the detail of the Regulations and to make a Regulatory Impact Assessment of the Regulations.

14. The Scottish Executive's view is that the current unregulated system does not operate in the best interests of Scottish Water and its customers, who are required to make a contribution to new connections with no guaranteed return on their investment nor clear basis for the level of their contribution. This lack of clarity and unregulated nature of contributions is not in developers' interests either, as they require certainty regarding new connections to allow them to reach commercial decisions.

15. At present, the unregulated arrangements whereby Scottish Water contributes to new connections mean that the income from a development may never cover Scottish Water's outlay, or maintenance costs may start to be incurred before the initial outlay is recovered. And where Scottish Water has laid infrastructure itself there is the risk of non-recompense, for example, if a development is halted or a developer goes bankrupt. These issues can be addressed by ensuring that Scottish Water's contribution is clearly linked to the income that will flow from a new connection, and ensuring that contributions are only made once a connection is completed.

16. This does not mean that Scottish Water should not make a contribution towards new connections: these bring a clear financial benefit to Scottish Water, in terms of increased charge income towards a service that has significant fixed costs. The Regulations therefore provide clarity on Scottish Water's contributions but will not necessarily reduce the contribution towards any given development. Instead they will ensure that Scottish Water contributes where this can be objectively justified.

17. For these reasons, the Scottish Executive believes that intervention to regulate Scottish Water's contributions towards new connections to the water and sewerage networks is appropriate.

Consultation

18. Early proposals to address the issue of contributions towards new connections were discussed in the consultation paper *The Water Services Bill – the Executive's Proposals*, published in March 2001. The issue was aired in more detail during the Parliamentary consideration of the Water Environment and Water Services (Scotland) Act 2003 which provided the enabling powers for Regulations on the issue. The principles that underpin the Regulations were discussed through the consultations on *Paying for Water Services* and *Investing in Water Services*, as set out in the previous section.

(i) Within Government

19. The Division within the Scottish Executive responsible for drafting this partial Regulatory Impact Assessment has consulted internally on its contents. We have also consulted Scottish Water and the Water Industry Commission.

(ii) Public Consultation

20. This partial Regulatory Impact Assessment is being published alongside the draft Regulations for full public consultation. It will be sent to a wide range of stakeholders, including business and construction industry representatives, and made available on the Scottish Executive website.

Estimation of Reasonable Cost

21. The draft Regulations provide that the level of contribution by Scottish Water towards local capacity should be based on an estimate of the benefit Scottish Water will receive from the new connection. This benefit is *part* of the charge income that will be received from customers served by the connection: although Scottish Water will receive a new or reinforced asset that should not require maintenance for a long period, the variable costs that all customers give rise to from using water and sewerage services will be incurred from the time of connection. An estimate used in the water industry is that an asset is generally in ‘new’ condition and requires little or no maintenance for 25 years. Based on the approximation that the charge income Scottish Water receives is roughly equally divided between asset maintenance or investment and ongoing costs, the full income for the first 12 years of an asset is a fair estimate of the benefit to Scottish Water from a new connection (although the consultation paper seeks views on whether a longer or shorter period should be chosen). This is the basis of the formula for calculating reasonable cost set out in the draft Regulations.

22. The other key variable in this formula is the income to be associated with a connection. The great majority of domestic households in Scotland are unmetered, and their maximum water and sewerage charges are set annually by the Water Industry Commission based on the council tax band of their property. This link between council tax bands and water charges means that those in higher banded properties pay a higher water and sewerage charge than those in lower banded properties. However, when a property is built, its council tax band cannot necessarily be predicted, nor may this banding reflect either the ongoing costs to Scottish Water or the costs of providing the new connection. An approach that reflected this banding could be seen as undermining the progressive cross-subsidy built into water charges, from those in higher banded properties, who tend to have higher incomes, to those in lower banded properties who tend to have lower incomes, by supporting the construction of large houses to the disadvantage of lower cost housing. For that reason, and to avoid the uncertainty and complexity of varying the level of contribution with a council tax band which may not be predicted with certainty, the draft Regulations provide for a single average charge income to be used for each water and sewerage connection. This is set as the mid-point between the charge for a band B and band C property, which approximates the average council tax band in Scotland.

23. The final factor in the calculation reflects that Scottish Water will make a contribution to the connection ahead of recouping the benefit through charge income. This means that Scottish Water is required to borrow the funds to meet contributions, and a factor to reflect the cost of that borrowing is added to the formula. An alternative approach would be for Scottish Water to make a contribution each year, but that would prolong the transaction for both Scottish Water and the developer unnecessarily, and we believe that a single transaction with this factor taken into account would be preferable.

24. This approach is broadly equivalent to that in England and Wales, which should help developers who operate on a UK-wide scale and provide a level playing field between development in different parts of the UK.

Options

25. In order to provide an appropriate framework within which to set the Regulatory Impact Assessment, a number of mutually exclusive policy options were identified and considered. These ranged from not making the Regulations, that is to say allowing the current unregulated system managed by Scottish Water to continue (the “do nothing” option), through to legislating for developers to pay all costs. In total, four options have been identified and their potential economic impacts assessed in turn:

Option 1: No Regulations – Scottish Water and developers would continue with the existing non-statutory arrangements (the “do nothing” option).

Option 2: Make Regulations to give Scottish Water a duty to make a reasonable cost contribution towards strategic local infrastructure only (what is sometimes termed ‘Part 3’ infrastructure). Developers would be required to meet all costs for the immediate connections to local mains and sewers and any work on them, or for any new local mains or sewers required (‘Part 1’ and ‘Part 2’ infrastructure).

Option 3: Make Regulations to give Scottish Water a duty to make a reasonable cost contribution towards local infrastructure. Developers to meet all costs for the immediate connections to local mains and sewers (‘Part 1’ infrastructure), as is current practice. This is our “preferred option”, provided for in the draft Regulations.

Option 4: Make Regulations to require developers to pay for all local infrastructure, with no reasonable cost contribution from Scottish Water.

The costs and benefits of each of these options are considered in the following sections.

Costs and Benefits – Sectors affected

26. In considering the costs and benefits of each of the options, it is important that the various sectors and groups on which the proposed Regulations will impact are properly identified and considered. This Regulatory Impact Assessment recognises that the following bodies and individuals might be affected by the different options:

- Individuals seeking first time connection to water and/or sewerage
- Private developers
- Public sector developers (e.g. housing associations, local authorities, Scottish Enterprise, Communities Scotland)
- Scottish Water
- Scottish Water’s customers
- Scottish Water’s regulators: the Water Industry Commission, the Scottish Environment Protection Agency and the Drinking Water Quality Regulator

Consultees are invited to identify any further sectors or organisations not listed above that they believe might be impacted upon by the Regulations.

Analysis of Costs and Benefits

27. The potential costs and benefits of each option to the different stakeholders are examined in turn below.

(i) Option 1

- **Benefits** – Retaining the unregulated current system could benefit developers, as Scottish Water would continue to pay towards local infrastructure without a guaranteed return. However, the lack of clear guidance on who would pay for local infrastructure is considered to hinder development, acting as a development constraint, so this may only be a minor benefit. This option might benefit first time connectees to the sewerage system, who currently receive a greater contribution than new build developers and benefit disproportionately from the current arrangements in comparison with other connectees. Option 1 might also benefit Scottish Water and its existing customers, since the contributions made by Scottish Water under the Regulations are likely to be greater than under the current system. However, if Scottish Water’s contributions are clearly linked to the income from connections, increased contributions will only be made where these are justified.
- **Costs** – For Scottish Water, continuing the status quo would mean continued expenditure towards connections that do not guarantee a future income. These costs would be borne by Scottish Water’s existing customers. Scottish Water would also continue to subsidise first time sewerage connections to a greater extent than other connections, without the guarantee of a suitable return. Option 1 would not provide the clarity and certainty for developers regarding responsibility for funding infrastructure that the draft Regulations provide and which should help to address development constraints.

(ii) Option 2

- **Benefits** - Option 2 would cost Scottish Water and its existing customers (as charge payers) less than Option 3, as they would only be required to make reasonable cost contributions towards the larger parts of local infrastructure. Where only very local infrastructure was required, Scottish Water would make no contribution. All Scottish Water’s expenditure would be clearly linked to the income from a new asset. Developers who do face a constraint in this type of infrastructure are likely to benefit from increased contributions compared to Option 1.
- **Costs** – Option 2 would place all connection costs on developers where investment was only required in very local infrastructure. It is estimated that due to sufficient existing capacity, 60% of sewerage connections and 95% of water connections fall into this category. If constraints in larger local infrastructure are more likely where large developments are involved, this option would disadvantage small developments and first time connectees. Costs to developers would be passed on to house owners or buyers where the development was private, and to the general and local taxpayer where these are incurred by local authorities or Communities Scotland.

(iii) **Option 3**

- **Benefits** – Option 3 is similar to Option 2 but spreads the same maximum Scottish Water contribution across all types of local infrastructure beyond the immediate connection to a local main or sewer. It would benefit all developers, including first time connectees, who are likely to have some requirements for this type of infrastructure. This is equitable, as all connections that are made will result in a future income to Scottish Water. It also more closely matches Scottish Water’s duty to make connections to the public network where this is practicable at reasonable cost compared to Option 2 which would target that contribution at a particular category of connection. Compared to Option 1, Option 3 is a regulated option which should ensure that Scottish Water incurs costs only to reflect future income from connections.
- **Costs** – Depending upon the final formula used to calculate Scottish Water’s contribution, this option is likely to cost Scottish Water and its customer base at least as much as Option 1, the “do nothing” option. However these contributions from Scottish Water will be limited to the financial benefit Scottish Water will receive from these connections, so that this amounts to no net contribution by Scottish Water. The draft Regulations are framed to ensure that there is a guaranteed financial return compared to Option 1. Developers would face a clear requirement to fund local infrastructure costs in excess of Scottish Water’s contribution. This option would be worse than Option 1 for first time sewerage connectees, but better for water connectees. It is likely to be better for all first time connections than Option 2.

(iv) **Option 4**

- **Benefits** – By only being required to meet strategic costs, Scottish Water and its customer base would benefit from this option, receiving new assets and the income that flows from them with no investment in local infrastructure.
- **Costs** – Costs would fall totally on developers and those seeking first time connections. In the case of developers, these costs could be expected to be passed on as increased prices for homebuyers, and would particularly affect low cost housing. Public sector developments would incur further costs for taxpayers. First time connectees would have to bear all their own connection costs, further increasing the barriers to them connecting to the public water and sewerage networks.

28. Option 3 was identified as the **preferred option**, on the grounds that it offered the most equitable basis for funding new water and sewerage connections for both developers and Scottish Water and its customers. It is closely founded in the primary legislation governing the provision of public water and sewerage services, and spreads Scottish Water’s contribution across a great proportion of the infrastructure which may require investment. It avoids benefiting or penalising particular types of connections – for example, individual first time connections where the greatest costs may be incurred in simply reaching the nearest point of the public system. It provides a clear division of responsibilities between Scottish Water and developers, and it recognises the value of new connections to Scottish Water by requiring it to make a contribution to connection costs which is consistent with the future income Scottish Water is expected to earn from new connections.

29. It is likely that there would be significant legal difficulties in pursuing Options 2 or 4 without further primary legislation.

Small and Micro Business Test

30. The draft Regulations will affect business through providing clarity as to developers' responsibility for funding all local water and sewerage infrastructure beyond that funded by Scottish Water's contribution. Depending upon the final formula used to calculate Scottish Water's contribution, it is likely that the Regulations will mean an increased contribution from Scottish Water. However, where development constraints in local infrastructure exist, these will remain a significant cost to developers in connecting to the public water and sewerage networks. It is difficult to generalise about where this investment would be required, but it may be more likely for those seeking to build large numbers of houses, compared to those making smaller developments that can be accommodated within existing systems. However, the key factor will always be a development's location and the proximity of and capacity in local water and sewerage infrastructure. As the draft Regulations only apply to connections to domestic premises, connections to new or existing commercial developments will not be affected by them.

31. Consultation on this partial Regulatory Impact Assessment will inform the Scottish Executive of the impact the Regulations will have on this important sector of the economy. The Scottish Executive will be consulting with groups and organisations that represent the interests of the relevant businesses, including the Federation of Small Business, the Federation of Private Business, the Confederation of British Industry, the Scottish Federation of Housing Associations, and Homes for Scotland.

This partial Regulatory Impact Assessment is particularly aimed at seeking the views of businesses on the implications of these Regulations for them. Small businesses and their representatives are particularly invited to respond to this consultation.

“Test Run” of Business Forms

32. While the draft Regulations do not introduce any new forms that will impact on the business sector, Scottish Water will be required to implement the Regulations, including developing any guidance and forms that they deem necessary to accompany them.

Competition Assessment

33. The Regulations are not expected to have an impact on competition within the house building industry, as reasonable cost contributions will be available equally across the sector. The use of an average income rather than basing this on the relevant council tax band removes any impact the Regulations might have had to over-compensate provision of larger housing units at the expense of smaller units. The Regulations establish on a statutory basis a payment that Scottish Water has already been making. Existing reasonable cost payments do not provide the main driver for the housing market, which is supply and demand of housing stock. However, the current lack of clarity as to responsibility for funding infrastructure can act as a constraint, which might impinge on competition in specific locations. The proposed Regulations will remove this uncertainty.

Enforcement, Sanctions and Monitoring

Enforcement

34. The Water Industry Commission and Scottish Water will be responsible for ensuring that the Regulations are properly enforced. Where disputes arise between Scottish Water and others over whether a reasonable cost has been properly determined under the Regulations, there are provisions under both the Sewerage (Scotland) Act 1968 and the Water (Scotland) Act 1980 (as amended by the Water Services etc. (Scotland) Act 2005) for those concerned to refer questions regarding the determination of reasonable cost to the Water Industry Commission. The Commission will devise the procedure for these appeals (previously considered by Scottish Ministers) before these Regulations are brought into force.

Sanctions

35. The legislation does not impose criminal sanctions for non-compliance.

Monitoring

36. The implementation of the Regulations will be monitored by the Scottish Executive, taking into account advice from Scottish Water, the Water Industry Commission and any representations from developers.

Annex 1 – List of Consultees

The list below indicates the extent of the initial distribution of the consultation paper, which totalled around 500 copies.

Age-related groups
Association of Scottish Community Councils
Audit Scotland
Building and construction industry organisations
Business representatives
Chambers of Commerce
Church/religious groups
Communities Scotland
Consumer organisations
Drinking Water Quality Regulator
Enterprise companies (including Local Enterprise Companies)
Environmental protection and sustainability interests
Equality groups
Historic Scotland
Legal interests
Local authorities (including CoSLA)
MSPs
National Park authorities
Planning interests
Rural and farming organisations
Scottish Civic Forum
Scottish Consumer Council
Scottish Environment Protection Agency
Scottish Federation of Housing Associations
Scottish MEPs and MPs
Scottish Natural Heritage
Scottish Parliament
Scottish Trades Union Congress
Scottish Water
Social housing interest bodies
Tourism interests (including VisitScotland)
UK Government departments and devolved administrations
Voluntary sector
Water Customer Consultation Panels
Water Industry Commission for Scotland
Water industry organisations

Annex 2 – Respondee Information form

Connecting to the System - Consultation on the draft Provision Of Water and Sewerage Services (Reasonable Cost) (Scotland) Regulations 2006

Please tear this page out, complete the details below and send it to us with your response. This will help ensure we handle your response appropriately:

Name/organisation:

Address:

.....

1. Are you responding as: (please tick one box)

- (a) an individual (go to 2a/b)
(b) **on behalf of** a group or organisation (go to 2c)

2a. **Individuals:**

Do you agree to your response being made available to the public (in SE library and/or on SE website)?

- Yes (go to 2b below)
No, not at all

2b. **Individuals:**

Where *confidentiality is not requested*, we will make your response available to the public on the following basis (**please tick one** of the following boxes)

- Yes, make my response, name and address all available
Yes, make my response available, but not my name or address
Yes, make my response and name available, but not my address

2c. **On behalf of Groups or Organisations:**

Your name and address as respondees *will be* made available to the public (in the SE library and/or on SE website). Are you content for your response to be made available also?

- Yes
No

3. We will share your response internally with other SE policy teams who may be addressing the issues you discuss. They may wish to contact you again in the future, but we require your permission to do so. Are you content for the Scottish Executive to contact you again in the future for consultation or research purposes?

- Yes
No

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This document is also available on the Scottish Executive website: www.scotland.gov.uk
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