

# Reporting to inform developer services regulation at PR24

Ofwat

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**FINAL**

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# 1. INTRODUCTION

## 1.1. OBJECTIVES

Ofwat previously commissioned CEPA to develop and assess options for the approach to regulation of developer services in PR24 and beyond.<sup>1</sup> Our work suggested that Ofwat has two high-level strategic options that it should consider in formulating its strategy for PR24, each of which reflect different points on a spectrum of relying more or less on ‘ex ante’ (i.e., price controls) versus ‘ex-post’ (i.e., monitoring and enforcement) regulation of developer services:

- Option 1a: an evolution of the current approach, where all developer services would continue to be price control regulated within the scope of the network plus price control, potentially with a view to a further transition towards greater separate regulation or deregulation of developer services at future price controls.
- Option 2: a more fundamental change in the approach to regulating developer services at PR24 that would be more reliant on ‘backstop’ regulation of contestable developer services, akin to Ofgem’s approach to regulating electricity new connections.

Based on currently available information, we concluded that Option 2 appears to be the more suitable ambition for PR24. Though it would require significant preparatory work ahead of PR24, in the long-term it offers the potential of a simpler approach to promoting customers’ interests in contestable developer services.

But this conclusion was based on an uncertain assessment of the current state of the market as we were unable to carry out a market study of developer services in England and Wales because of the absence of good quality information. For example, it is currently challenging to assess the degree of contestability across different types of new development (e.g., large and small) and different regions of England and Wales, and/or define the relevant product and geographic market(s) in developer services.

As a result, one of the recommendations of our study was that better and more granular data should be collected to assess competition and define relevant developer services markets. Enhanced collection and use of developer services data could enable Ofwat to conduct a more comprehensive ‘state of the market’ review. This may provide more confidence that an option that relies more on competition can be justified (i.e., Option 2). Improvements in data (revenues, costs and mix of work/developments undertaken) may also be used to consider refinements to existing uncertainty mechanisms within the price control under Option 1a, e.g., the developer services reconciliation adjustment (DSRA), and/or again to support the evolution of the cost assessment at PR24.<sup>2</sup>

More specifically, we identified that better quality information was needed on a range of elements, including:

- Demand and supply information - data that might be used to provide indicators of the current and future state of competition in different regions of the country and by different types of new development.
- Costs and revenues - data on incumbent company costs and revenues for different types of developer services and development types. This may help with the design of price control arrangements, the cost assessment undertaken at the price review, and provide further market indicators.
- Cost drivers - data on the drivers of incumbent company developer services costs. This may help with design of price control arrangements and the cost assessment undertaken at the price review.

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<sup>1</sup> Available here: <https://www.ofwat.gov.uk/publication/cepa-approach-to-the-regulation-of-developer-services-at-pr24/>

<sup>2</sup> For example, the treatment of expected different programmes of growth activity between incumbent areas during PR24.

Ofwat has subsequently commissioned CEPA to undertake a small project extension, which asks CEPA to assess how Ofwat could improve its understanding of appropriate ways to segment different types of new developments in the water sector and consider the state of competition within contestable developer services, in particular, which activities are actively contested by self-lay providers (SLPs) and new appointees (NAV).

Specifically, Ofwat wants to improve its data collection so that it has sufficient evidence to allow it to make appropriate adjustments to price controls that reflect changes in market activity over time or decide to adopt a different approach to developer services regulation at PR24 or future price control periods.

Ofwat currently collect data from the incumbent water and wastewater companies primarily through annual performance reports (APRs), which each incumbent must publish annually. Ofwat use Regulatory Accounting Guidelines (RAGs) to set out the content and format of the APRs, and changes to the RAGs include a formal consultation as part of the process.

## **1.2. APPROACH**

We have undertaken work in four phases:

- Review of existing data collected on market activity and desk-based research on the type of information that Ofwat may want to collect through the RAGs.
- Development of an initial set of ideas for data collection, informed by bilateral discussions with a number of incumbent water companies.
- A workshop with incumbent water companies to expose the relevant issues and draw input and insight in order to inform what further regulatory reporting may be feasible and useful.
- Development of recommendations on how Ofwat may amend the RAGs for 2021-22 and other regulatory reporting processes to collect sufficient market information to support decisions on price controls for developer services activities.

## **1.3. DOCUMENT STRUCTURE**

This short report captures the key outputs from the engagement process, including key risks, concerns and opportunities raised by stakeholders, and should be considered alongside our proposed updates to the RAGs.

The remainder of the report is structured as follows:

- Section 2 outlines existing developer services data collection.
- Section 3 presents key findings from the stakeholder engagement process.
- Section 4 concludes with a summary of our proposed amendments to RAGs.

## 2. EXISTING DEVELOPER SERVICES DATA COLLECTION

This section outlines the existing developer services data that is due to be collected through the latest APR (financial year 2020-21), and consequently the gaps in the data collected in the APR, with regards to demand and supply information, and cost, revenue and cost driver data.

### 2.1. SEGMENTATION

To define relevant market segments of developer services in terms of whether there is or is not effective competition constraints on incumbent's behaviour, Ofwat will need to first collect demand and supply related data for different new development activities. It can then analyse the data to determine whether there is evidence of an active market for a particular developer services activity.

Developer services data is currently collected at a reasonably aggregate level. This has meant Ofwat has only been able to obtain a partial view of competitive forces. A best practice state of competition assessment of developer services would seek to define relevant market(s) from both a product and geographical perspective.<sup>3</sup>

Developer services data needs to be segmented in a sufficient way to allow Ofwat to assess demand and supply side influences on the competitive constraints that incumbents face for different types of new development. This may require data reporting that is most consistent with how incumbents, SLPs and NAVs differentiate between different types of developments when running their businesses.

The latest APR is not currently set up to achieve this. But the data provided in company PR19 business plan tables (but not requested in the latest APR) provide helpful insights on how best to segment developer services data as the incumbents were asked to allocate forecast developer services costs, revenues and volumes (properties connected) into a maximum of 5 bands, using a volume banding of their choice. The incumbents had a substantial amount of discretion on how they provided that data. This led to an inconsistent reporting approach and was ultimately why Ofwat was unable to use the data within the PR19 Final Determination. But the data submissions help to identify a number of characteristics that the incumbents may think about when differentiating between types of new development, whilst recognising that the approaches applied in reporting the data may in part be guided by Ofwat's instructions (i.e., volume banding). These characteristics include:

- **Services required** – connections to existing mains, and connections to new mains.
- **Development size** – there was no consensus on how to define a small, medium and large development. A small development was defined as less than 5 properties by some companies and less than 10 properties by others. A couple of companies also considered single property connections alongside connections to existing mains. Medium sized developments were mostly defined as up to 100 properties, with large developments mostly defined as over 100 properties.
- **Development site ground condition** – unsurfaced / soft ground and surfaced / hard ground.
- **Connection / customer type** – standard (25mm or 32mm / domestic) or non-standard (>32mm / non-domestic) connection.

Lessons could also be learnt from Ofgem's approach to regulating electricity new connections segments, which is based on the following characteristics / product definition:

- **Size of development** (i.e., new developments of less than 5 properties are deemed non-contestable)
- **Customer type** (i.e., metered demand, metered distribution generation, and unmetered connections)

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<sup>3</sup> OFT (2004): 'Market definition – Understanding competition law'

- **Type of services required** (e.g., low, high or extra high voltage work)

## 2.2. DEMAND AND SUPPLY INFORMATION

To date, data collected by Ofwat to assess the level of competition in developer services has focused primarily on the level of SLP and NAV penetration in each incumbent’s operating area in terms of new connections, new properties and length of mains laid. But this is unlikely to show the full picture.

This suggests that Ofwat should collect data to enable it to conduct a more detailed review of competition in developer services, which may inform the option it takes forward in PR24 regarding the regulation of developer services and how it might segment developments in terms of regulatory treatment (if applicable).

For example, it is not currently possible to assess SLP and NAV penetration for different types of development within an incumbent’s operating area or assess the level of supply concentration. The former is important because competition may be sufficient to meet the needs and interests of some customers but not others because of differences in the level of competition for different developer services segments. The latter is important because many active third parties providing developer services should in theory drive down prices and improve service quality. But a small number of dominating third-party suppliers may not deliver the full benefits of competitive pressures Ofwat would ideally envisage.

In addition, data currently collected on properties connected and mains laid are ‘lagged’ market indicators as they only show up in the data when a new property or main is connected to the water network, which may be a long time after the new development commenced. Additional data on quotations issued may help to provide more of a ‘live’ view on the state of developer services competition.

*Table 2.1: Review of developer services information currently collected*

| Data currently collected                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Potential data gaps                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                |
|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• Number of new connections served by the incumbent.</li> <li>• Number of new connections made by the SLP but served by the incumbent.</li> <li>• Number of new properties served by the incumbent.</li> <li>• Number of new properties served by NAVs.</li> <li>• Number of new properties where the service connections were made by the SLP.</li> <li>• Total length of new mains laid by the incumbent.</li> <li>• Total length of new mains laid by SLPs.</li> </ul> | <ul style="list-style-type: none"> <li>• SLP / NAV penetration for different development types / segments. This could be defined by a combination of the segmentation characteristics described in Section 2.1.</li> <li>• Developer awareness of alternative supply routes / quotations issued.</li> <li>• Number of active SLPs/NAVs in an incumbent’s operating area.</li> <li>• Share of contestable services work undertaken by each developer services provider in an incumbent’s operating area.</li> </ul> |

*Source: CEPA analysis of APR data*

## 2.3. COST AND REVENUE DATA

Developer services revenue data (or sometimes referred to as grants and contributions) has historically been reported at a relatively high level of granularity. Whereas historical developer services costs have not been explicitly collected. This led to Ofwat relying on developer services revenue rather than costs within the PR19 developer services revenue adjustment (DSRA) mechanism<sup>4</sup> and made it challenging to conduct standalone developer services cost assessment.

<sup>4</sup> Grants and contributions (before the deduction of any discounts) should be a reasonable proxy for developer services costs given the requirement on incumbent companies to set cost reflective developer services charges.

Ofwat has substantially increased the granularity of developer services cost data reporting in the latest 2020-21 APR with the aim of being more closely aligned with developer services revenue and reduce cost reporting inconsistencies between incumbent water companies.

But the 2020-21 APR did not request data on developer services costs and revenues broken down by different development types / segments, which could be defined by a combination of the segmentation characteristics described in Section 2.1. Similarly, companies are not currently asked to separately report indirect developer services costs (i.e., overheads), which makes it challenging to assess whether companies are taking different approaches to indirect cost allocation.

More disaggregated cost and revenue data would be needed if Ofwat were to choose to exclude all, or parts of, contestable developer services from the wholesale network price controls, and may also be helpful if Ofwat decides to undertake standalone developer services cost assessment at PR24.

*Table 2.2: Review of developer services cost and revenue data currently collected*

| Data currently collected                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         | Potential data gaps                                                                                                                                                                                                                                                                                   |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• Developer services costs are broken down based on the type of work, and are closely aligned with developer services revenue:               <ul style="list-style-type: none"> <li>○ New connections</li> <li>○ Requisition mains</li> <li>○ Infrastructure network reinforcement</li> <li>○ S185 diversions<sup>5</sup></li> <li>○ Other price-controlled activities</li> </ul> </li> <li>• Developer services revenue (i.e., grants and contributions) is broken down into:               <ul style="list-style-type: none"> <li>○ Connection charges</li> <li>○ Requisitioned mains</li> <li>○ Infrastructure charge receipts</li> <li>○ S185 diversions</li> <li>○ Other price control contributions</li> <li>○ Income offset</li> </ul> </li> </ul> | <ul style="list-style-type: none"> <li>• Cost and revenue data broken down by different development types / segments</li> <li>• Costs and revenues broken down by contestable versus non-contestable developer services</li> <li>• Separate reporting of indirect developer services costs</li> </ul> |

*Source: CEPA analysis of APR data*

## **2.4. COST DRIVERS**

Cost driver data is important to accurately assess developer services costs, which would be expected if some or all of developer services remains a price-controlled activity.

Developer services cost driver data collection has mainly focused on the volume of new properties connected, and length of new mains laid, by the incumbent, SLP or NAV to date. But collection of new connections and mains laid broken down into different development types / segments, which could be defined by a combination of the segmentation characteristics described in Section 2.1, would provide additional cost driver information and might also be used to help Ofwat to obtain a fuller picture of competitive forces (e.g., unit cost trends for different development types / segments across different incumbent).

<sup>5</sup> A water main or sewer diversion requested under Section 185 of the Water Industry Act 1991.

Table 2.3: Review of developer services cost driver data currently collected

| Data currently collected                                                                                                                                                                                                                                                                                                                                                                                                                  | Potential data gaps                                                                                                                                                                                                                         |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• Total number of new connections</li> <li>• Total number of new connected properties</li> <li>• Number of connections made by SLPs</li> <li>• Number of properties connected by SLPs</li> <li>• Number of new properties served by NAVs</li> <li>• Length of mains laid by SLPs</li> <li>• Other explanatory variables captured in the PR19 wholesale base cost models (e.g., density)</li> </ul> | <ul style="list-style-type: none"> <li>• New connections and mains laid broken down into different development types / segments</li> <li>• Other potential developer services cost drivers (e.g., length of communication pipe).</li> </ul> |

Source: CEPA analysis of APR data

## 2.5. SUMMARY

A substantial amount of developer services data is currently collected but important gaps remain. Particularly with regards to demand and supply information of developer services, which is currently not sufficient to facilitate a comprehensive review of the state of competition.

### **3. KEY FINDINGS FROM STAKEHOLDER ENGAGEMENT**

In this section we set out key findings from a workshop with the incumbent companies to assess:

- Whether the current developer services data gaps outlined in Section 2 can be filled with data that is currently collected in the industry?
- If not, what issues does that create for the industry (i.e., additional data collection; cost allocation; reporting system changes; etc.)?

#### **3.1. SEGMENTATION**

When thinking about segmenting developer services data, there was a broad consensus that it is important to differentiate between connections to the existing network that require no new infrastructure / mains (i.e., infill development) and larger developments that require new infrastructure / mains. The incumbents considered that SLPs and NAVs do not have much of a financial incentive to compete for work that does not require any new infrastructure / mains, particularly if traffic management is required. These findings are in line with the incumbents' approach to allocating developer services costs, revenues and volumes in their PR19 business plan data tables that was discussed in Section 2.

The incumbents considered that segmentation by 'development size' would be more subjective and may lead to allocation problems (costs and volumes), as was experienced in the PR19 business plan data tables. But they did provide anecdotal evidence that SLPs tend to express most interest in development sites with more than 50 connecting properties, and NAVs tend to express most interest in development sites with more than 100 connecting properties.<sup>6</sup>

One incumbent said there may also be considerable regional variation in the degree of competition within an incumbent operating area, which may also need to be considered. Although the incumbent recognised that this would add complexity to an issue that another incumbent said was unlikely to be widespread.

#### **3.2. DEMAND AND SUPPLY INFORMATION**

The table below presents our assessment of whether the developer services demand and supply information gaps can be filled with data available from the incumbent companies.

Overall, the incumbents seemed confident that they could provide more disaggregated market information data but highlighted concerns around data quality given the issues around data reporting inconsistencies that were found in PR19 business plan data table submissions regarding developer services (i.e., APP28). They also raised the point that NAVs are better placed to provide data on properties served by NAVs than the incumbents.

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<sup>6</sup> We note that United Utilities said in its PR19 business plan that they did not consider the size of the development significantly impacted the average revenue per connection. Instead, they considered the two main drivers for differences in average revenue per connection were: (i) whether a standard (25mm) or non-standard connection (>25mm) was required and (ii) whether the connection was on surfaced or unsurfaced ground. Thames Water also allocated developer services data based on surface type (soft or hard ground).

Table 3.1: Market information data gaps – stakeholder feedback

| Current data gaps                                                                                                                                                 | Feedback from incumbents                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                  |
|-------------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <p>SLP / NAV penetration for different development types / segments, which could be defined by a combination of the characteristics described in Section 2.1.</p> | <ul style="list-style-type: none"> <li>• The incumbents say they can report accurate data on what proportion of service connections, mains and other assets are provided by SLPs and NAVs, and this could be broken down into different development types / segments.</li> <li>• But the incumbents did note that data on properties served by NAVs should be provided by NAVs rather than the incumbent water company.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                        |
| <p>Developer awareness of alternative supply routes / quotations issued.</p>                                                                                      | <ul style="list-style-type: none"> <li>• The incumbents agreed that quotation data could be provided and would provide a more ‘live’ view on the level of competition as some developments can take several years to complete.</li> <li>• But they noted that issues may arise that would need considering: <ul style="list-style-type: none"> <li>○ <i>Data quality</i> – incumbents can receive multiple self-lay approaches per site, but it is not always clear how many of those lead to actual quotes.</li> <li>○ <i>Data reporting inconsistencies</i> - caused by the provision of different quotes by incumbent water companies. For example, some companies provide a convertible quote, which sets out the price if they undertake all the work and also the price if they only undertaken the non-contestable work, whereas others do not.</li> <li>○ <i>Division of contestable work between the incumbent and SLP</i> – some incumbents raised concerns around the split of contestable work undertaken between the incumbent and the SLP and how that would be captured in the data. For example, in some cases the SLP may only undertake part of the contestable work available (less than 100%).</li> </ul> </li> </ul> |
| <p>Number of active SLPs/NAVs in an incumbent’s operating area.</p>                                                                                               | <ul style="list-style-type: none"> <li>• The incumbents said they should be able to provide a list, and number, of distinct SLPs and NAVs who have undertaken developer services work in their operating area in any given year. They noted this data / metric could be tracked over time to assess how long each provider has been active.</li> <li>• But it was also noted that this data may not uncover the precise number of active SLPs and NAVs in an incumbent’s area given it would omit those who have competed for work but have been unsuccessful.</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |
| <p>Market share of each developer services provider in an incumbent’s operating area</p>                                                                          | <ul style="list-style-type: none"> <li>• The incumbents may be able to provide data on the volume of developer services work (e.g., accepted quotes, properties connected, mains laid) undertaken by different developer services providers, which would facilitate an assessment of market concentration.</li> <li>• But data on costs incurred by SLPs and NAVs would not be available unless it was requested directly from them, which means market share/concentration analysis would be limited to volumes only (e.g., accepted quotes).</li> </ul>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                 |

Source: CEPA analysis of stakeholder feedback

### 3.3. COST AND REVENUE DATA

The incumbents confirmed that the additional granularity of developer services cost data requested in the 2020-21 APR should reduce data reporting inconsistencies between companies.

In particular, it was noted that companies apply different accounting reporting treatments to developer services costs, with some companies fully capitalising developer services costs whereas others classify a proportion of developer services costs as opex. This previously affected unit cost comparisons. But the latest APR asks

companies to disaggregate developer services costs into capex and opex, which should mitigate the issue. Developer services revenue collection should also largely be unaffected by the split between opex and capex given that developer services customers pay for the work on completion.<sup>7</sup>

One issue that may still need resolving is within Regulatory Accounting Guidelines (RAG) 2.08 – Guideline for classification of costs across the price controls, which currently states that costs associated with the provision of developer services information and administration for new connections should be allocated to retail rather than wholesale.<sup>8</sup> Ofwat may want to consider changing the guidance so that companies allocate all developer services costs to wholesale network plus to ensure that developer services costs and revenues are reported consistently under the same price control, which should in turn improve comparability between companies.

Another issue is the treatment of asset payments that are currently made by the incumbent Welsh companies to SLPs but are no longer made by incumbent English companies. While a relatively minor issue, it will be important to consider whether this inconsistency affects unit cost comparability between English and Welsh incumbents.

The table below presents our assessment of whether the developer services cost and revenue data gaps can be filled with data available from the incumbent companies.

*Table 3.2: Cost and revenue data gaps – stakeholder feedback*

| Current data gaps                                                                       | Feedback from incumbents                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      |
|-----------------------------------------------------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Cost and revenue data broken down by different development types / segments             | <ul style="list-style-type: none"> <li>• The incumbents said that it should be possible to allocate costs and revenues to different development types / segments. But it would be important to specify tight definitions to minimize data reporting inconsistencies, and sufficient time would be needed to implement necessary changes to data reporting systems and to review data (i.e., peer review).</li> <li>• If development types / segments are defined based on development size, it will be important to ensure that the same definition of a connected property is applied by all incumbents.</li> </ul>                                                                                                                                                                                                          |
| Costs and revenues broken down by contestable versus non-contestable developer services | <ul style="list-style-type: none"> <li>• The incumbents said that it may be possible to allocate costs and revenues to contestable and non-contestable developer services. But it would be more challenging than by development type / segment, and some assumptions may need to be applied, particularly for administration and support costs (e.g., design/application fees), which could lead to reporting inconsistencies.</li> <li>• There was a general consensus that close to 100 percent of site-specific developer services costs (service connections, requisitions and diversions) are contestable.</li> <li>• As above, tight definitions must be used, and sufficient time must be allowed to allow the incumbents to put in place appropriate reporting processes and to review the requested data.</li> </ul> |
| Separate reporting of indirect developer services costs                                 | <ul style="list-style-type: none"> <li>• Indirect developer services costs could be separately reported.</li> <li>• But indirect costs are likely to vary substantially between companies due to different approaches to overhead allocation. Some companies follow the RAG2 guidance, which sets out what costs should be included in overheads, whereas others appear not to.</li> <li>• It may therefore be appropriate to agree on a consistent approach to overhead allocation to developer services, which could improve unit cost comparability (albeit may reduce cost reflectiveness in some cases).</li> </ul>                                                                                                                                                                                                      |

*Source: CEPA analysis of stakeholder feedback*

<sup>7</sup> The proportion of developer services costs funded by existing customers would be impacted by the opex capex split.

<sup>8</sup> Ofwat, 2021. RAG 2.08 – Guideline for classification of costs across the price controls.

Overall, the incumbents stated that costs and revenue could be broken down by different development types / segments and contestable / non-contestable. But it would be important to specify definitions tightly to minimise data reporting inconsistencies, which may be challenging in some cases given that each company has a different definition of ‘contestable’ developer services. Data could be peer reviewed to identify any data reporting errors and/or inconsistencies. Companies would also need to be allowed sufficient time to implement necessary data reporting system changes.

### 3.4. COST DRIVERS

The incumbents considered that site specific developer services work should be more comparable than network reinforcement. The incumbents agreed that length of communication pipe and development site ground type (e.g., soft / unsurfaced versus hard / surfaced ground) were potential drivers of site-specific costs in addition to the volume of properties connected and length of mains laid.

Turning to network reinforcement, the incumbents noted that reinforcement expenditure potentially could be split into new infrastructure, incremental upgrades and rebuild as different categories of reinforcement have different cost drivers. Similarly, one company also noted that they were unsure of where to report reinforcement expenditure if it was incurred in advance of a development being built. But generally, the incumbents consider that network reinforcement expenditure is more difficult to benchmark and may be better assessed separately outside of the base cost models due to the specific nature of the expenditure.

*Table 3.3: Cost driver data gaps – stakeholder feedback*

| Current data gaps                                                                      | Feedback from incumbents                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                         |
|----------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| New connections and mains laid broken down into different development types / segments | <ul style="list-style-type: none"> <li>• This data could be provided as long as sufficient time was given to implement data reporting changes. The importance of tight definitions was highlighted to ensure comparable data between companies.</li> </ul>                                                                                                                                                                                                                                                                                                                       |
| Other potential developer services cost drivers                                        | <ul style="list-style-type: none"> <li>• The incumbents agreed that the length of communication pipe and development site ground type are drivers of site-specific costs. No other cost drivers were identified other than traffic management costs.</li> <li>• The incumbents noted that network reinforcement is more challenging to benchmark and may be better assessed outside of the base cost models. Further disaggregation of network reinforcement costs into new infrastructure, incremental upgrades and rebuild may facilitate a better cost assessment.</li> </ul> |

*Source: CEPA analysis of stakeholder feedback*

## 4. CONCLUSIONS

Overall, the incumbent water and wastewater companies were generally open to providing additional developer services data and information based on the feedback provided in the workshop, as long as:

- **Reporting requirements are well defined** to avoid reporting inconsistencies between companies caused by ambiguity in definitions.
- **Sufficient time is allowed** to implement data reporting system and process changes.
- **The data will be used effectively by Ofwat.** References were made to the additional developer services data that was provided during the PR19 process but was ultimately not used to inform the final determination.

### Segmentation

The desk-based review of existing developer services information and engagement with incumbents as part of this project did not identify a consensus on how the developer services data should be segmented. But several development characteristics were identified that could be used to inform the segmentation.

Figure 4.1: Selected development characteristics

| Services required                                                                                                                                                                 | Development size                                                                                                      | Development site ground condition                                                                                                            | Customer type                                                                                                                                                            |
|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <ul style="list-style-type: none"> <li>• Connection only.</li> <li>• Connection and new water mains / sewers.</li> <li>• Excavation undertaken by developer themselves</li> </ul> | <ul style="list-style-type: none"> <li>• Number of properties</li> <li>• Length of new mains / sewers laid</li> </ul> | <ul style="list-style-type: none"> <li>• Surfaced / made (i.e., road or footpath) or unsurfaced / unmade (i.e., grass or topsoil)</li> </ul> | <ul style="list-style-type: none"> <li>• Standard or non-standard connection</li> <li>• Metered or unmetered</li> <li>• Domestic or non-domestic end-customer</li> </ul> |

Source: CEPA

An SLP noted that there is no clear rules or criteria for deciding whether they decide to compete for contestable developer services work. Rather they seek to assess all developments based on what its clients ask them to quote for to see if they can be competitive and earn a sufficient margin. The SLP also said that small developments in some cases can be as profitable as larger developments based on the type of work that is required. In other words, they do not immediately rule out work based on any one criterion.

Developer services data segmented based on the characteristics above would therefore allow the demand and supply data to speak for itself, which may in turn help to identify whether there are different developer services product markets, with varying levels of competition within those markets.

We are mindful however that developer services data segmented based on the characteristics above would lead to a large data request that would be challenging and time consuming for the incumbents to complete. A high level of developer services data disaggregation would also increase the risk of data reporting inconsistencies between incumbents.

We have therefore considered what level of granularity might be requested to ensure meaningful analysis and conclusions can be drawn and that the developer services segmentation choice does not overly influence the relevant market assessment.

Firstly, we recognize that disaggregating data into new developments served by the incumbents and new developments served by NAVs is important as NAVs are better placed to provide data on NAV sites.

Secondly, we think developer services data segmentation based on the **services required** (e.g., whether new water mains are required or not) and **development size** are likely to be the two most important characteristics to capture and most feasible for the incumbents. But Ofwat should confirm this with the incumbents before finalizing the 2021/22 RAGs.

Disaggregation of cost and revenue data into site-specific (service connection, mains/sewer requisition, and diversion), local network reinforcement and indirect / other data will also be required to mirror the current data collection processes. Although some incumbents have highlighted the challenge of allocating reinforcement and indirect costs to specific development types.

A further disaggregation of data based on the proportion of contestable work undertaken by the incumbent is also likely to be important to ensure that data can be compared on a like-for-like basis (i.e., scope of activities undertaken by the incumbent is approximately the same when comparing different developments).

Ofwat may want to explore the level of data disaggregation / segmentation further with the incumbents before finalizing the 2021/22 RAGs to assess the feasibility of the data request and to ensure the information provided in the data request can be used effectively.

## **Demand and supply information**

The incumbents were reasonably confident they could provide more disaggregated demand and supply information data, with the aim of providing Ofwat with a fuller picture on competition in the developer services market:

- **SLP / NAV market penetration for different development types / segments**
- **Quotation data**, which would provide a more up to date view on the level of competition. Data on the number of offers and quote value would need to be requested on accepted, partially accepted (i.e., non-contestable only) and rejected quotes to capture the different scenarios that can take place when a quote is provided. An increase in the number of partially accepted or rejected claims over time, or decreasing unit costs over time, may provide an indication that competition is growing. Third party quote information would also be valuable, but the incumbents are unlikely to have accurate data on this. They can receive multiple self-lay enquiries for the same site, but they do not have sight of whether those enquiries lead to quotes.
- **Number and list of SLPs and NAVs who have undertaken developer services work** in their operating area in any given year, the volume of developer services work they have undertaken, and the number of years they have competed for developer services work / participated in the market. This information would facilitate an assessment of market concentration.

## **Costs and revenues**

The incumbents were confident they could provide costs and revenue broken down by different development types / segments and contestable / non-contestable developer services. But it would be important to specify definitions tightly to minimise data reporting inconsistencies.

Ofwat should also consider amending RAG 2.08 so that companies allocate all developer services costs to the wholesale network plus price controls and not between wholesale and retail.

## **Cost drivers**

The incumbents agreed that additional cost driver data could be helpful on the length of communication pipe and ground surface type. No other cost drivers were explicitly mentioned. But the incumbents stressed the difficulty in benchmarking network reinforcement costs, and some companies suggested that these costs should be removed from the base cost models and assessed separately.

## **Developer services data request**

A draft developer services data request accompanies this working paper and reflects the conclusions above.



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