

**PR24 draft methodology**

**Design and implementation of price controls webinar**

13<sup>th</sup> July 2022

**ofwat**

# Agenda

Item	09:30 – 10:30
Introduction	09:30 – 09:35
Design of price controls	09:35 – 10:00
Water resources	
Developer services	
Retail controls	
Bioresources	10:00 – 10:30
Direct procurement for customers	
Consultation questions, timeline and next steps	
Q&A	



# Introduction

The purpose of this webinar is to provide an **overview of our proposals for the design of the separate controls** that we will set for different parts of the value chain for water companies

Further information on our proposals is published in:

- **Chapter 3 of our consultation document;**
- [Appendix 2 – Water trading incentive;](#)
- [Appendix 3 – Developer services;](#)
- [Appendix 4 – Bioresources control;](#) and
- [Appendix 5 – Direct procurement for customers.](#)

There will be an opportunity for questions at the end of the webinar. The purpose of the question and answer session is to **provide clarification** on our proposals. The purpose is not to debate our proposals

We are **recording this webinar** and may share with Defra and the Welsh Government.

We intend to **publish these slides and a summary note** of the questions and answers on our website.

Please ensure you are on mute, and **we ask that questions are submitted via the chat function** to ensure all companies have an equal opportunity to ask questions. Please include your name and the company you represent alongside your question.



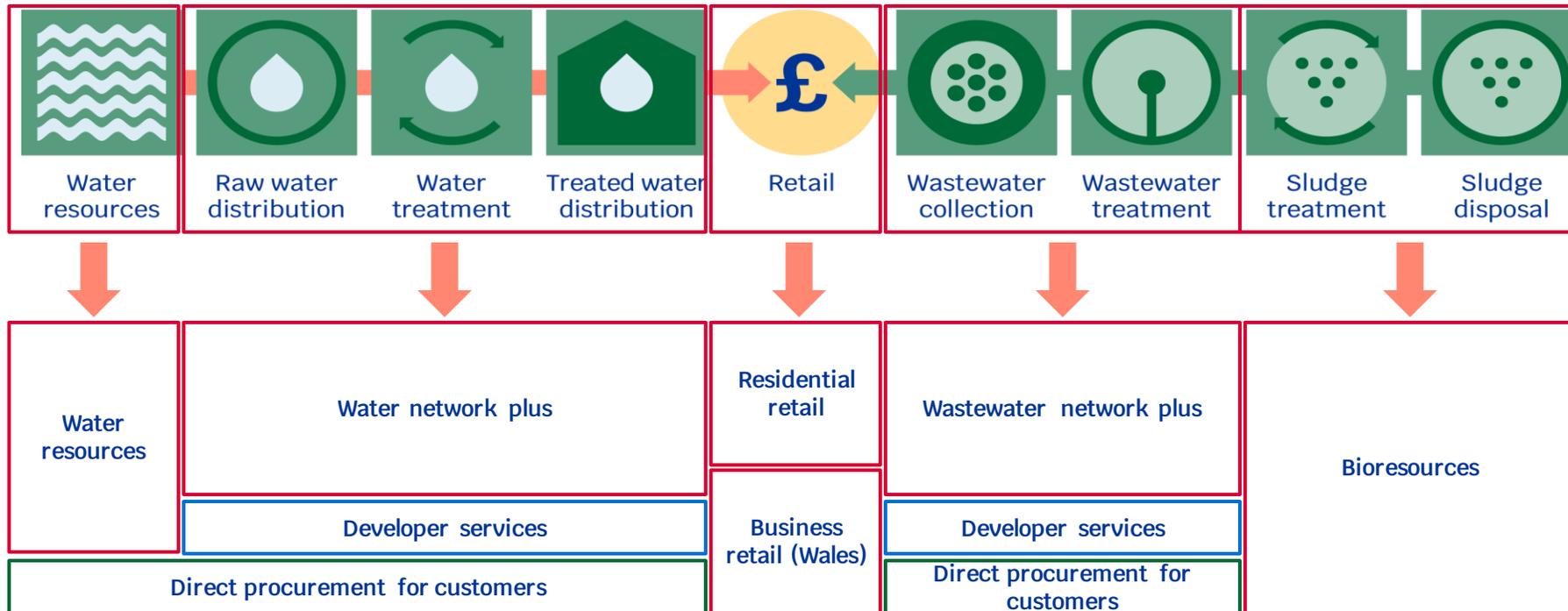
# Design of price controls

We are retaining the separate controls we established at PR19:

- Water resources and network plus are total revenue controls
- Retail and bioresources are average revenue controls

For each control we will:

- set efficient expenditure allowances (totex)
- assess in-period expenditure and additions to RCV
- calculate returns on, and run-off of, RCV
- include a tax allowance



# Water resources control

## Upstream markets

- We are retaining the bidding market.
- There will be no bilateral market for PR24 (and the BEAM removed for this period).
- We welcome views in your responses on possible improvements to transparency of market information.

## Trading incentive

- Current incentive rolled-over for PR24, but will change for PR29.
- We welcome views on two possible approaches (the details are set out in appendix 2).

## RCV risk

- We are removing the requirement to have utilisation risk sharing requirements for PR24.
- Where material investment is proposed for low utilisation assets, we expect business plans, supported by long-term delivery strategies, to fully evidence the options suitability over smaller, modular or operational type interventions.

## Control boundary

- This remains unchanged from PR19.



## Network reinforcement

We propose that network reinforcement remains in the water and wastewater network plus controls

We seek stakeholders views on whether:

- 1) to apply a reconciliation mechanism to network reinforcement investment requirements; or
- 2) if cost sharing is sufficient

## Wastewater site-specific developer services

We propose that wastewater site-specific developer services are excluded from the wastewater network plus price control because nearly all are delivered by self lay providers or the housing developer

We will consider whether any changes to charging rules are needed to protect customers in cases where developers can only use the incumbent wastewater company (eg sites with access issues)

## Water site-specific developer services

There is strong competition for large developments, but relatively low competition for small developments

We propose to exclude new developments of more than 25 properties from the water network plus price control. But propose to introduce transitional arrangements for companies with low levels of third-party activity in this market segment

We propose that new developments of 25 properties and below should either:

- remain in the water network plus control; or
- be removed from the water network plus control but with alternative protections to protect developer services customers in this market segment

## Other developer services issues

We conclude there is no convincing justification for income offset, and that any discount or surcharge reflecting environmental or social issues should have a clear rationale

## Retail controls

At PR24 we therefore propose to set:

- a price control for the residential retail activities of English and Welsh companies; and
- a price control for business retail activities of Welsh companies

### Protecting retail customers not eligible for competition in England and Wales

- We propose setting an average revenue control based on the number of customers companies need to serve
- We propose no automatic indexation of allowed revenue
- We propose a reconciliation to correct for any over- or under-recovery of revenue

### Protecting large business customers in Wales

- We propose to align our approach with the Retail Exit Code (REC) for large business customers served by English water companies who have been transferred to business retailers. The current REC does not specify price caps for premises using 50 megalitres a year or more of water
- We propose ensuring customers below the eligibility threshold for competition are protected using the average revenue control described above

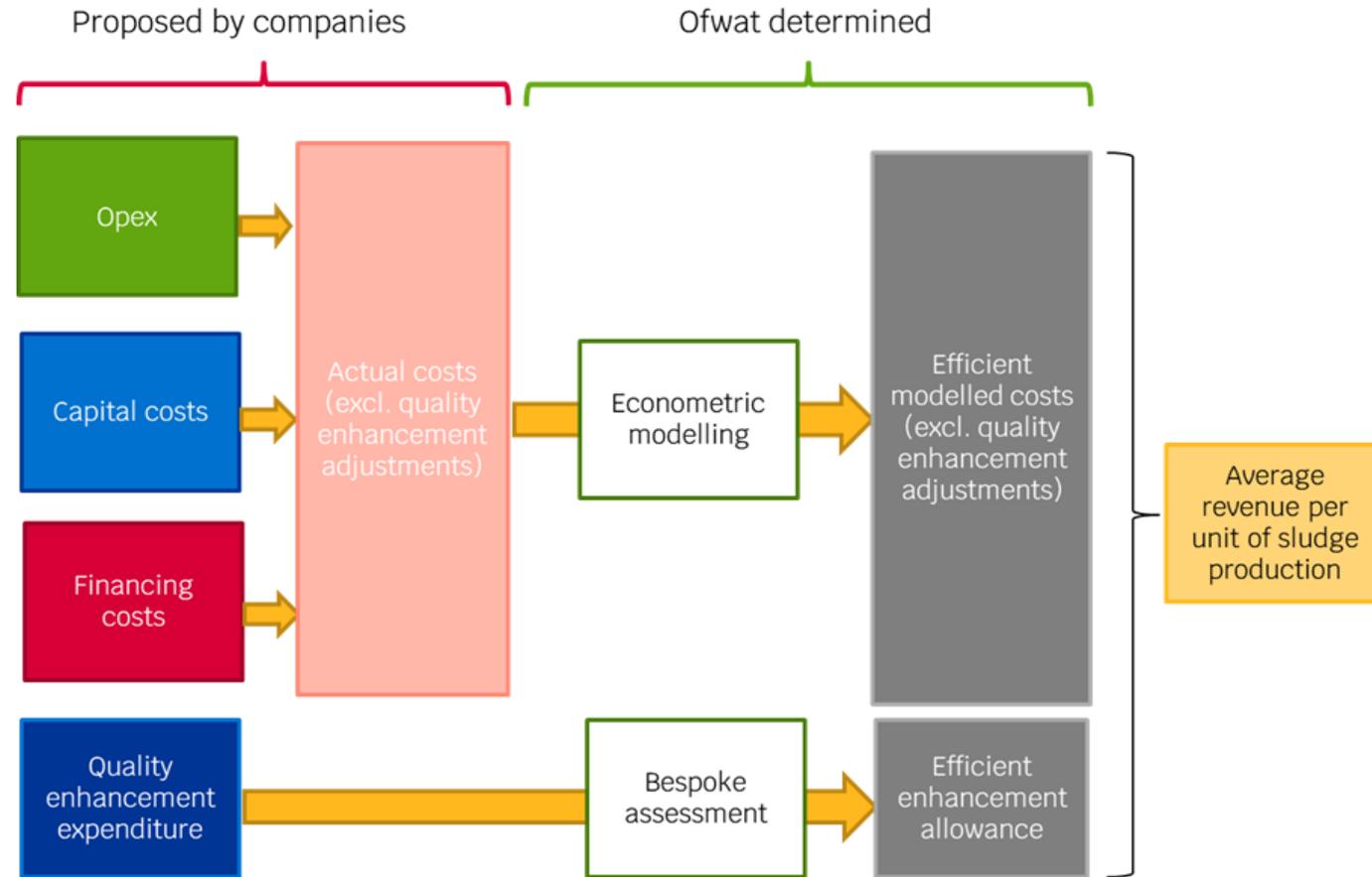


# Bioresources: a more market-based control

This would involve:

- Moving away from the ‘building blocks’ approach with its reliance on RCV to one where more costs are benchmarked together.
- Capturing a greater share of enhancement costs through our econometric cost benchmarking modelling, rather than separate assessments.
- Including financing costs within our econometric cost benchmarking models, rather than making a separate adjustment.
- Setting companies' allowed revenue in the form of an average revenue control – this is more akin to a gate price.
- Providing no cost sharing for bioresources.

Overview of the proposed bioresources control at PR24



# Bioresources: approach to implementation

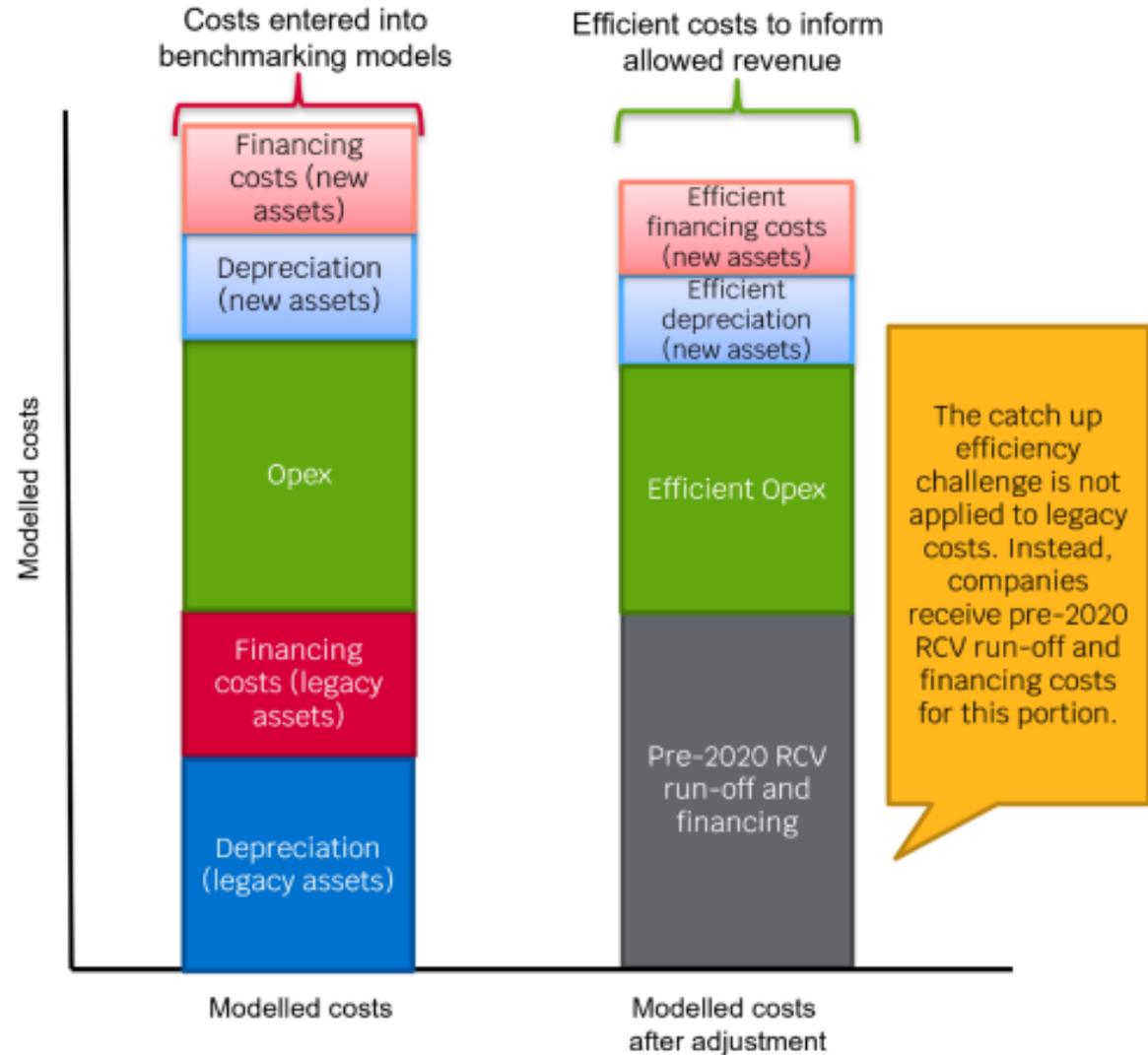
This would involve:

- Providing a higher level of regulatory protection for pre-2020 RCV investment
- A separate efficiency challenge for the bioresources control to drive further efficiency.

We clarify that the asset base for bioresources from 2025 onwards would continue to be recorded as RCV

To help test this and clarify how our proposals could work in practice and their potential impact, **we will publish a supplementary document by 2 September 2022**

To allow stakeholders to consider this supplement, **we have extended the deadline for responses to our bioresources proposals to 5pm 16 September 2022**



## Direct Procurement for Customers

- We expect companies to use DPC by default for all projects above our DPC size threshold, which will increase to around £200m of lifetime totex. This applies to all parts of the water and wastewater value chain, apart from bioresources.
- We will not include funding for in-house delivery of DPC eligible schemes when we set price controls. Instead, we will allow funding for companies to run the DPC procurement process for eligible schemes.
- PR19 DPC procurement principles and DPC contract principles will be replaced by new guidance and engineering guidance on separability will be revised (pre-final methodology).
- Existing DPC licence conditions will be reviewed to ensure that they are still fit-for-purpose and then added to the licences of companies with DPC eligible schemes at PR24 (expected date: late 2023/early 2024).



# Consultation questions

## Water resources

Q3.1. Do you agree that in our final methodology we should commit to introducing either an adapted water trading incentive or a new water trading incentive at PR29? If you have a preferred approach, please provide reasons, including any thoughts on how the options we set out in Appendix 2 could be improved.

## Developer services

Q3.2. Do you agree with our proposals to:

- a) Continue to include network reinforcement in the network plus price controls?
- b) Remove wastewater site-specific developer services from the wholesale wastewater
- c) network plus price control?

Q3.3 Do you agree that the inclusion of network reinforcement in cost sharing would be enough to manage uncertainty around the volume and mix of network reinforcement work to be delivered?

Q3.4. For water site-specific developer services:

- a) Do you agree with our proposal to exclude new developments of more than 25 properties from the wholesale water network plus price control at PR24, but with transitional arrangements for companies with low levels of competition?
- b) Do you think that new developments of 25 properties and fewer should remain in the wholesale water network plus control or be removed? If they were removed from the price control, what alternative protections could we introduce to protect new connection customers from monopoly power?



# Consultation questions

## Direct Procurement for Customers

Q3.5. Do you agree with our proposals:

- a) To raise the size threshold above which companies should deliver schemes through DPC to around £200m lifetime totex?
- b) For companies to deliver schemes through DPC by default above this threshold?

## General

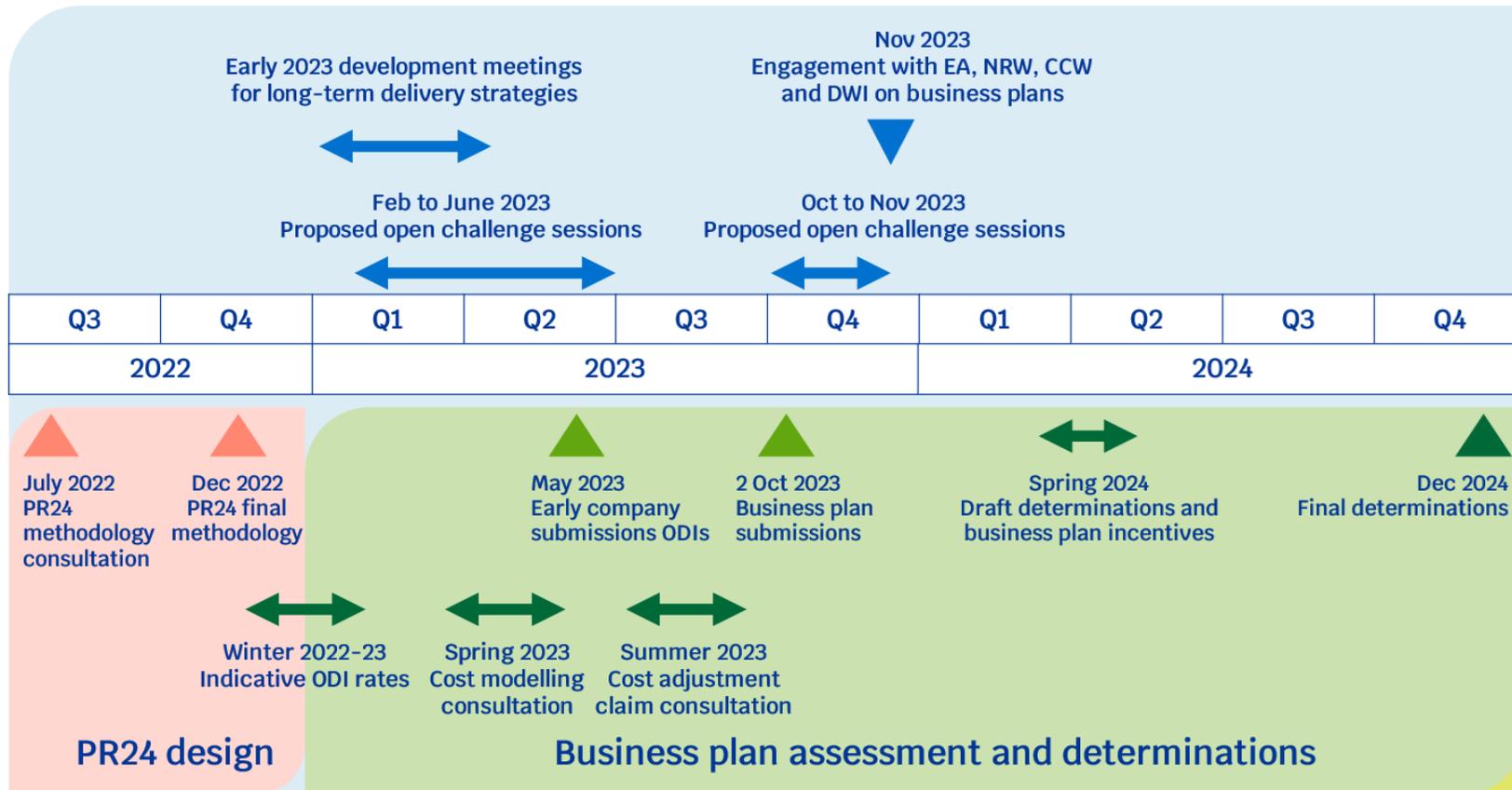
Q3.6. Do you have any views on any other aspect of our proposals in Chapter 3?



# PR24 timeline and next steps

Consultation responses to our draft methodology proposals are due 7<sup>th</sup> September @ 5pm

Except for bioresources, where the deadline for responses to our proposals is extended to 16<sup>th</sup> September @ 5pm given our plans to publish a supplementary document by the 2<sup>nd</sup> September



# Thank you and questions

