Response to Ofwat's Consultation on Changing Charging Rules to support the new developer services framework

27/10/23

Introduction

Thank you for the opportunity to consult on these proposed changes to the charging rules. Alongside the changes introduced as part of PR24 we support a charging rules framework that continues to protect developer services customers and supports choices in the developer services market.

The developer services market is by nature slow to grow due to the long-term nature of projects. However, it is our view that the market for the provision of developer services is growing with competitors increasing their market share and offering additional choice for customers. As an example, for NWL, the number and proportion of new properties connected by NAVs doubled in 2022/23. For customers not requiring new water mains, the majority of connections are provided under a fully competitive market.

Q1: What are your views on our proposal to link charges for different types of development through the use of tether ratios? What are your thoughts on the use of ratios based on industry maximum figures, not average or median figures?

We agree that the use of maximum industry tether figures would allow for cost reflective charging variations across companies for types of connections, at varying levels of efficiency.

We agree that the approach must be to protect customers, not to apply an efficiency challenge. Requiring inefficient companies to charge less than costs in a competitive market would be anti-competitive.

Q2: What are your views on option 5 that companies should individually charge for separate activities involved in making service connections? Do you agree with our proposal to implement via changes to the wording of the CTWE?

We would support this option in order to promote transparency and consistency amongst charges for customers.

Q3: Do you have views on our proposals to add two new worked examples with the aim of providing additional protection for developments with limited choice? (e.g. a housing development of 5/25 properties not requiring new mains)

We support the proposal to add new worked examples to the charging arrangements.

We would support all companies providing easily comparable information for these types of customers.

Q4: Do you agree with our proposed general guidance for RAG2 regarding a fair allocation of all relevant overheads across ALL expenditure areas, including developer services.

We are supportive of providing general guidance regarding overheads and would propose that OFWAT provide principle-based guidance rather than specific rulings.

Q5. Should RAG2 specify methods of overhead recovery for developer services? Are there any disadvantages to doing so? Are there any methods that you think would be appropriate to use across the industry that would drive consistency?

Our current approach is to apply separate overheads for labour, materials, and contractor costs. We would support this approach across the industry.

Q6) Do you agree that RAG2 could be extended to cover the recovery and allocation of overhead costs between developments with and without a mains requirement? Do you have any suggestions as to how this should be done?

We do not have any objections to this proposal in principle, provided that guidance is applied on a principles-based approach rather than overly prescriptive.

Q7. What are your views on our proposal to carry out a market review prior to PR29

We have observed that NAVs/SLPs continue to grow and gain more business within the market. Given that the market is currently achieving these outcomes we would query the objectives of any future market review and would also welcome the inclusion of criteria around the performance of these competitor organisations within the market.

Q8. What are your views on our proposal that companies include historical variances between expenditure and revenues in setting infrastructure charges?

This proposal appears to reverse the guidance set out in June 2021 that required a purely forward looking calculation of infrastructure charges. We supported the original approach as the least volatile and most predictable way of setting infrastructure charges.

Ofwat are now proposing to introduce an additional source of volatility – the recovery of prior year variances.

The guidance does not state whether this adjustment must be made immediately upon reporting (i.e. on a reporting year plus 2 basis), or can also be spread over the 5 year period.

It is important to note that network reinforcement expenditure is 'lumpy' and the timing can vary. A large variance in either direction for a single year can arise due to the unpredictable timing of a major development for example.

To try to correct for this variance in full in a year+2 adjustment to infrastructure charges risks those charges varying significantly compared to prior and subsequent years.

For these reasons, we suggest Ofwat clarifies that adjustments for prior over/under recovery should be made on the same 5 year basis as the forward looking charges.

We also suggest a worked example would clarify the calculation. It should confirm that the policy should be designed to minimise cumulative variances rather than eliminating them altogether (which is not possible on a lagged 2 year basis).

Q9. Do you agree with our proposal to enable companies to take account of upsized infrastructure when setting infrastructure charges.

We support this proposal as it would provide greater flexibility to recover the costs of upsizing infrastructure in anticipation of future demand. This should allow for greater efficiency and a greater return on investment in future capacity.

Q10. What are your views on our proposals relating to how we accommodate changes to the provision of income offset?

We would support this proposal and are no longer offering an income offset. We would suggest that all costs related to income offset should be stripped from any presentational format for transparency and comparison purposes, including worked examples and reporting.

Northumbrian Water
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