

Consultation on changing Ofwat's charging rules to support the new developer services framework

Severn Trent response

October 2023

WONDERFUL ON TAP



Summary of response

We welcome the opportunity to respond to the consultation on changing Ofwat's charging rules to compliment the deregulation of certain aspects of developer services that will be implemented as part of our price review 2024.

Please find below specific comments in respect to each of the questions are contained within this document.

Should you require any further information please do not hesitate to contact me.

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On behalf of Developer Services

Response to detailed questions

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?

The existing charging rules require all companies to be cost reflective, recovering all reasonable costs, and there are already several other protection mechanisms in place whereby all companies consider compliance with competition law and the effects of their charges in terms of D-MeX outcomes. Therefore, we do not believe there is a need to add this additional complexity to further protect customers. There is high potential a tether ratio will distort the operation of an effective market, upsetting competition and not support customer service.

Additionally, there could be risks associated with introducing this approach which is based on published bill stability scenarios at a point in time:

- Timing and how often refreshed.
 - There is a risk that the tether ratio becomes out of date and does not reflect economic conditions.
 - There may be companies that are continuing their journey to become fully cost reflective during this AMP resulting in tether ratios that are currently unrealistic.
- Comparability
 - Differences in how companies allocate overheads will impact comparative unit costs.
 - Contractual arrangements and renewal timeframes will differ between companies and the construct of charging arrangements differ.
 - The current worked examples may not be comparable where regional differences provide for different dig methods; for example, in scenario four Severn Trent do not excavate service connections because it is not a service our customers request but, other companies do. Therefore, this provides for a non-comparative unit cost that could read unfavourably when published without further explanation/transparency. In uncertain economic times stakeholders may study this and come to an unreasonable conclusion in terms of charge comparability, potentially influencing where they choose to undertake development.
- Innovation/methodology change
 - This approach could discourage companies from finding cost efficiencies that do not impact on all customers as this could distort the ratios.
 - Charge methodology changes, such as the unbundling of a current charge, could result in variances which could pose a challenge in terms of cost reflectivity and predictability.
- Market shift
 - Tether ratios set at a point in time may not be sufficiently responsive to developer market movement. This could lead delays in work being undertaken for developers or asking organisations to make a loss.
- Contracts
 - Tethering limits the unit costs posing a risk in uncertain economic times. Contractors may opt for higher profit margin work elsewhere, and

- cherry picking could increase the average costs of charges for the types of customers that incumbents serve.

In terms of using industry maximum figures we do believe that using the maximum would be preferable to the average or median figures as necessary to support cost reflective charges.

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 support the principle that charges should be transparent, where appropriate in consideration of contractual confidentiality and, without adding complexity for customers. It's also important to ensure the approach is one that customers do wish for.

Based on the proposal, companies would need to revisit contractual detail to ensure there is an adequate split of charge elements. Also, there would need to be additional guidance to enable comparability. We would suggest the following for example:

- Non-construction
 - In terms of administration fees, setting out what activity elements should be included within the administration fee to ensure there is commonality in charge methodology and transparency for customers by including within the Common Terms.
- Construction connection fee (pipework per meter, traffic management, meters) –
 - In terms of connections fees, including a reasonable pipework allowance supports companies' ability to provide predictable and efficient quoting with ease of use for our customers. From an operational practicality perspective, the location of the main connecting to is unlikely to be precise to the centimetre. Each job will be unique in many ways and charges needs to manage this practicality as simply as possible.

We note that whilst transparency is generally a good thing it may not result in more homogeneous charges across the industry because companies' costs are different, with differing levels of efficiency and delivery models.

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? What are your views on suitable new scenarios?

In principle we are supportive of providing customers with further examples where examples reflect likely scenarios.

To differentiate from scenario 1 and add value as a new example we suggest that the 5-property scenario utilise a manifold placed in the footpath with the main in type ¾ carriageway.

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 would welcome guidance and a common framework to support consistency regarding what should be recovered through overheads and how to apply within developer services. The timing of this is important in the context of companies PR24 business plans. We would welcome this before PR24 is finalised.

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?

We believe that RAG2 should specify methods of overhead recovery for developer services to enable consistency and reduce ambiguity.

There is however a risk in moving to a specific method from a position where companies interpretations currently differ. Because companies apply overheads differently a change in guidelines may result in significant differences in chargers. We would therefore suggest a transition period.

We recommend Ofwat set up an industry working group to ensure that as much agreement as possible can be reached and the direction of travel smoothed. We would be happy to partake in such a working group.

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 recommend that all allocation is picked up through the proposed working group. It would provide clarity on expectations.

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

Historically, developer services had extremely light touch regulation and reporting requirements. Since the introduction of the charging rules the degree of regulation and reporting has continued to increase resulting in a significant amount of insight now being available through APR, D-MeX and the more recent RFIs. There are several working groups, industry and customer forums that enable engagement and collaboration as the market evolves; both at an industry and incumbent level.

We suggest that Ofwat review the need for this in light of what happens early in AMP8 and consider the proportionality of further information gathering in this area. Particularly, in light of the rate at which competition has grown and the size of Developer Services overall in terms of water company activity and, the degree of regulatory oversight that is already in place. Increased regulation and reporting could potentially conflict with the operation and effectiveness of competitive markets. Maybe the fundamental question is do OFWAT wish to use market forces and competition to drive value for customers or more reporting, regulations, and control mechanisms?

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

We agree that companies should move to reconciling and adjusting for variances between expenditure and revenues in setting infrastructure charges at a programme level. It's important that developer customers pay a fair charge reflecting network reinforcement activity due to growth.

We thank Ofwat for their response to our query. To date, it hasn't been possible to correct for historic imbalances and therefore they have not been accounted for in companies' future plans which will not be in line with the proposed new rule. Companies would need to revise forecasts to take account of this which could result in bill volatility for customers. We suggest that this proposed change is wholly forward looking from April 2025. Our view is that it would be inappropriate to go into a new AMP adjusting for the prior AMP whereby the existing rule, relevant at the time, does not allow for adjustment. We would also suggest the rule be amended to make it clear that imbalances in AMP7, prior to the rule change, need not be accounted for.

Guidance on how to practically manage this to drive consistency would be beneficial. As an example, should revenue recovered versus amount spent be reconciled over an AMP period? Over what timeframe any difference needs to be accounted for would need to be clear to all stakeholders in advance.

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

We agree with the proposal to enable companies to take account of upsized infrastructure when setting infrastructure charges.

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

We support the proposals.