Draft Determination Representations

WSH.DD.OO.3

Response to the proposed approach to regulating developer services

30 August 2019

Contents

1. Introduction

1.1. Purpose and structure of this document

The draft determination contained a proposal to change the approach to regulating developer services within PR19 in the document "Our proposed approach to regulating developer services." The document also made it clear that the draft determinations did not fully reflect the proposals. Subsequently, a conference call was held on Friday 16th August to discuss and clarify points in the document and the developer services data request that was issued alongside the document.[1] A note of the meeting "Developer services conference call: follow up note 20th August 2019" was issued subsequently. Alongside this, there have been a number of queries on this matter which have been published in "22.08.19 Common-questions-and-responses-on-DDs-20190822." This document contains our response to the proposals in the light of all of these. A further note "Supplementary information for all companies – Grants and contributions" has also been circulated.

In summary, we support this change of approach as a pragmatic way to resolve the issues that were inherent with the PR19 methodology. However, as at PR14, this is an area that does not seem to have been given the same level of attention as other areas. We strongly believe that there should be a thorough review of the treatment of developer services costs and income through the "single till" for PR24 and would, of course, be very willing to contribute to this.

It has to be remembered that the regime overarching this area is different for the English based companies, our response is based on the applicability of the proposed changes for the determination of the revenue control as it applies in Wales. We ask that Ofwat makes clear how it has considered this in the final determination.

This document follows the same structure as the proposal document and each section presents our understanding of the proposal; sets out any specific questions and comments on the proposed option.

The sections are:

2   Developer services end-of-period reconciliation

3   Incentivising accurate developer services forecasts

4   Treatment of developer services in the control

5   Treatment of diversions

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[1] For the record we found this conference call most useful and an exemplary way for evolving issues to be resolved.

2. Developer services end-of-period reconciliation

Proposal

The preferred approach is to introduce a reconciliation approach based on a common cost driver to generate a company-specific unit rate. A solution more closely associated with the cost modelling approach helping to ensure that the reconciliation mechanism works as intended. The unit rate would be calculated from the companies' submission (adjusted for Ofwat's view of botex plus efficiency) and so would reflect the companies' own view of the forecast mix of work.

The proposed formula for the calculation was provided. The follow up note clarified that the properties to be used in the true-up formula (FC_t) would be those used by Ofwat in the base cost assessment modelling.

Questions

There were no specific questions raised.

Comments

We agree that option 2 is the most pragmatic solution to the issues identified with the original approach, especially given the change in approach to modelling the associated costs. This, together with the removal of the, less predictable, NRSWA diversions means that use of aggregate unit costs is not an unreasonable approach to take at this late stage in the process.

We see no problems with the proposed formula for implementation. We ask that this formula and the tables A1 and A2 (as amended) are included in the Final Determination notice document for clarity.

3. Incentivising accurate developer services forecasts

Proposal

The preferred approach is to eliminate the developer services forecasting incentive and move developer services back into the Revenue Forecasting Incentive.

Questions

There were no specific questions raised.

Comments

We agree that option 2 is the better option.

4. Treatment of developer services in the control

Proposal

The preferred approach is to ensure a consistent approach between the data used for the calculation of net totex and the developer services reconciliation, based on grants and contributions gross revenue.

Questions

There were no specific questions raised.

Comments

We agree that option 2 is the better option and welcome the recognition that the English companies are different.

5. Treatment of diversions

Proposal

The preferred approach is to set non-section 185 diversions income outside of the price control. The proposal is to change Licence condition B to expand the list of "Excluded Charges" to exclude include from diversions except for those undertaken under s185. A proposed definition is provided in the document.

Questions

Companies were asked whether they would agree to a licence change and to review the proposed wording of the proposed definition.

Comments

We support the proposal. We can see no reason why we would not agree to the licence change, subject to the required consultation process, and have no comments on the proposed definition.