

# Setting price controls in 2014

A briefing note for household customers in Wales

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## Delivering sustainable water

**A**s a water and sewerage customer in Wales you deserve excellent service at a fair price. We are the economic regulator for the water and sewerage sectors in Wales and England. Our goal is to make sure that your water company delivers the service you want at a price that is good value for money.

We are consulting on how we will set the price and service package ('price controls') the monopoly water and sewerage and water only companies – including those in Wales – must deliver to customers during each of the five years from 2015 to 2020. We have developed our price limits methodology framework through extensive consultation with:

- customers like you;
- water companies;
- the Welsh Government;
- the UK Government; and
- other key stakeholders within the water sector.

This briefing note sets out what our proposals mean for you.

### Overview

We want the needs of customers like you to be at the heart of water companies' business strategies.

A key feature of our proposals is, for the first time, to set separate price controls for:

- retail water and sewerage services to household customers;
- retail water and sewerage services to non-household (business) customers;
- wholesale water services; and
- wholesale sewerage services.

By setting these distinct controls, we can target our regulation on the different activities that companies carry out. This is essential if we are to encourage them to focus on what their customers want, while driving efficiency. We want to keep prices down, while encouraging innovation and sustainable solutions to managing this valuable and precious resource.

This is in line with the Welsh and UK Governments' thinking and is also a key part of our long-term plan for a sustainable water sector.

Our proposed framework will:

- help provide you with a **better service**;
- ensure a **secure, sustainable supply**; and
- help **deliver value in tough times**.

### 1. A better service for you

We are living in tough economic times – recent reports claim that [household income in Wales has fallen](#) by about £80 a month in just

one year and the Welsh Government estimates that bad debt in the water sector currently adds about £20 onto every customer's bill each year. We also know that average household water and sewerage bills in Wales have gone up significantly since 2010 – broadly in line with inflation but by more than 7% overall. This focuses us on getting the best result for customers when we next set price controls. We are also working with the Welsh Government to consider options to address bad debt and promote high standards of service for customers.

## What we intend to do and how this will affect you

We want to make sure you get the service and delivery that you deserve and value. To ensure this happens, we want water companies to take your needs into account in their long-term plans. We have required each water company operating in Wales to improve its customer engagement and set up a customer challenge group (CCG). This group will challenge companies to engage with you properly and reflect your views and needs in their business plans. This will mean the following.

- Companies will draw up the outcomes they will deliver based on customers' views and priorities alongside their legal obligations.
- The CCGs will challenge companies, focusing on how well they have engaged with their customers, and whether their proposals reflect customer priorities.
- We will make the final assessment of companies' proposals, and we will listen carefully to the views of the CCG when we do this.
- Where companies have listened to their customers and done a good job, we will accept their version of what they propose to deliver and concentrate on challenging costs.
- If business plans do not take customers' priorities into account, we will challenge costs and also require changes to make sure that customers' needs are recognised.

To bring the water sector in line with others across the economy the retail part of your bill – which reflects the costs of serving you as a customer, like sending you bills – will no longer rise automatically in line with inflation (although wholesale costs will remain index linked to the Retail Price Index, or RPI, to keep financing costs low). We will challenge water companies to improve their retail businesses by reaching, or beating, the average cost to serve a household customer. This will help keep bills manageable for hard-pressed households.

We will continue to drive improved services through targeted regulation. For example, each year we score water companies' performance on things like:

- complaints;
- call-out times; and
- the time taken to make repairs.

The best performing companies are rewarded while those that perform less well are encouraged to improve. This is our service incentive mechanism (SIM), which we will continue to use.

Our approach has already driven [significant benefits in Wales](#), where Dŵr Cymru received 58% fewer customer complaints between April 2011 and 2012 compared with the previous year, and Dee Valley Water received nearly 15% fewer over the same period.

We will also make sure that you benefit from efficiencies in wholesale services (sourcing, treating and transporting water), which will ensure better value for money for you.

## 2. Ensuring a secure, sustainable supply

The Welsh Government recognises that water is a precious resource and that it is often undervalued. And managing it sustainably is becoming ever more challenging in the face of changing weather patterns. The year 2012 was the second wettest since records began in the UK. And [four of the top five wettest years have occurred since 2000](#) – part of a global trend towards more extreme rainfall events. The impact of this is devastating – during 2012 just over 1,000 properties in Wales were flooded.

And while Wales did not experience any drought in 2012, several companies in south-east England were preparing to find extra water supplies and had imposed hosepipe bans, restricting the volume of water their customers could use. These drought conditions were caused by exceptionally low groundwater levels in many areas of England because [the previous 18 months were the driest for more than 100 years](#).

This is a key issue in Wales, where [research](#) suggests there will be an increased threat of flooding in the winter, and droughts in summer.

At the same time, our population is growing, where people are choosing to live is affecting water demand and new water intensive industries are emerging – like 'fracking' (exploiting shale gas).

We need to make sure water is available where and when we

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need it most. According to the Environment Agency, more than half of the UK's rivers are over-abstracted (which means too much water is taken from them), while others have plentiful supplies. But at the moment, less than 5% of the water in the UK is traded between companies across regions.

The challenges we face here in Wales reflect what is happening globally, which means water is rising up the agenda worldwide. Indeed, some energy commentators have suggested that water is the new oil<sup>1</sup>.

### **What we intend to do and how this will affect you**

Making water companies focus on delivering the outcomes their customers want will mean they have more freedom to decide how to deliver these outcomes. This could lead to new ways of working that can deliver the services you want, for less money and with less impact on the environment.

For example, rather than increasing bills by building an expensive water treatment plant to meet environmental standards, a company could work with local farmers and land owners to avoid pollution entering rivers in the first place, which could be a cheaper, more sustainable solution.

We want to encourage water companies to find more sustainable ways to meet their customers' needs, while also improving resilience. By increasing the volume of water traded between companies we

will begin to get a better understanding of the true value of this precious resource – not just economically but to us as a society and to our environment. Then companies can make better informed decisions on where to invest and how to balance supply and demand pressures.

The Welsh Government supports ways to reduce demand for water, including water trading. If there is a hosepipe ban in your area while a neighbouring region has adequate supplies, companies will be better able to import water to ensure your supply is not affected.

At the same time, to make sure this is done in a way that does not harm the natural environment, we will encourage companies to source water from where it does not damage the environment and penalise them if they take it from where it does. We will do this in way that is similar to how we encourage service improvement. Our tool for this is called the abstraction incentive mechanism or AIM.

Together, the incentives we are putting into our wholesale price controls will encourage companies to manage water resources more sustainably and ensure supplies are more secure, while improving efficiency.

### **3. Delivering value in tough times**

Efficient and effective water companies are good for the Welsh economy. Turnover in the Welsh water sector is currently about

£700 million a year, and about £7.8 billion has been invested over the past 24 years. Each year, companies in Wales spend about £350 million on improving services for customers and enhancing and maintaining the natural environment.

We need to make sure that this essential investment can continue. But the solutions of the past are not necessarily the right solutions for the future. New, emerging challenges mean water companies need to be more innovative and deliver more efficient and sustainable solutions, without adding to your already stretched finances.

Ultimately, it is customers who pay the price for inefficient investments or wasted water – whether it is they or the company that waste it. They also bear the risk of higher prices or more frequent restrictions on the water they use if supplies become unsustainable in the future.

### **What we intend to do and how this will affect you**

We are creating an environment where water companies are better able to serve you, while still keeping costs fair. Our framework will provide water companies with greater flexibility to respond to your needs – first by making them focus on your views in their long-term business plans. Ensuring your water company engages with you will help you get the service you want, for a fair price.

And we want to see your water company spending your money

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<sup>1</sup> Forbes magazine, 3 May 2012

on projects that are necessary. This is to ensure that water is used efficiently and waste is limited. As new challenges emerge, including new industries and uses for water that change demand for it within the economy, our framework will provide the water sector with greater flexibility to respond to those challenges.

In total, we estimate that our reforms will deliver £500 million to the UK economy from retail reform<sup>2</sup>. But we recognise that the Welsh Government's policy on retail reform is different from that

in England. The Welsh Government is committed to delivering effective results for household customers in Wales. Reforming the way we manage wholesale water services – like supporting water trading that recognises the true value of water – could help deliver another £2 billion of benefits.

And to make sure that water companies can secure the investment needed to deliver these benefits, we will continue to regulate the monopoly aspects of the water sector in a transparent,

low-risk way, including linking wholesale prices to RPI. The stability this delivers will keep the cost of borrowing for water companies low, enabling them to secure affordable long-term financing and keep your bills down.

## Conclusion

It is essential that the Welsh water sector is customer focused, resilient and efficient – and that water is valued as a precious and finite resource. Through this framework we want to make sure that:

- companies can make the right decisions based on the real value of water to our economy, environment and society;
- investors retain their confidence in the water sector and the finance needed to continue to invest can be sourced at a good price to customers;
- businesses – and, in turn, the economy – can benefit from greater choice and influence over the services they receive; and
- consumers have a resilient service and pay a fair price.

## More information

[‘Involving customers in price setting – Ofwat’s customer engagement policy statement’](#), Ofwat, August 2011

[‘Future price limits – statement of principles’](#), Ofwat, May 2012

[‘High emissions scenarios’](#), UK Climate Projections, May 2012

[‘Consultation on retail price controls for the 2014 price review’](#), Ofwat, July 2012

[‘Consultation on wholesale incentives for the 2014 price review’](#), Ofwat, August 2012

[‘Written complaint handling in the water industry England and Wales: April 2011 – March 2012’](#), Consumer Council for Water, September 2012

[‘Food banks increase as Wales incomes fall £80 per month’](#), BBC News, October 2012

[‘Review of the 2010-2012 drought and prospects for water resources in 2013’](#), Environment Agency, December 2012

[‘Met Office: 2012 was UK’s second wettest year on record’](#), BBC News, January 2013

<sup>2</sup> [‘Future price limits – statement of principles. Appendix 1: Impact assessment’](#), Ofwat, 2012



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**Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We are responsible for making sure that the water and sewerage sectors in England and Wales provide consumers with a good quality and efficient service at a fair price.**

**Water today, water tomorrow**