

Setting price controls in 2014

A briefing note for business and other non-household customers in England

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Delivering sustainable water

As a water and sewerage customer you deserve excellent service at a fair price. We are the economic regulator for the water and sewerage sectors in England and Wales. 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 must deliver for 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;
- Government; and
- other key stakeholders within the water and sewerage sectors.

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

Overview

Our vision for the sectors is one that delivers water today for customers like you – and tomorrow for future generations. We share this vision with the UK

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.

Government, which has recently published its Water White Paper and Draft Water Bill.

Our proposed framework will:

- help you get a **better service**;
- ensure a **secure, sustainable supply**; and
- provide **support to our economy in tough times**.

Currently just 2% of non-household customers in England and Wales can choose their water supplier. The UK Government's Draft Water Bill proposes to change this. At the same time, we want to keep prices fair, while encouraging water companies to innovate and find sustainable

solutions to manage this precious resource for everyone.

1. A better service for you

We know that businesses like yours are under significant pressure in these tough economic times. We also know that you are under constant pressure from your customers and competitors to deliver more for less. It is our job to make sure the same pressure is applied to your local monopoly water company on your behalf.

One cost that you have little control over is that of managing your dealings with your water and sewerage service supplier.

The way you receive your water and sewerage services can be complex. If you are a company with a number of outlets, you may find that each one is treated as a different customer, despite belonging to one business. We know some customers that have taken on external consultants to make sure that their bills are properly managed and any mistakes are corrected. A [Policy Exchange report](#) in July 2011 highlighted that one business would be able to save between £80,000 and £200,000 by receiving just one water and sewerage bill, instead of its usual 4,000 bills from a number of different water companies.

What we intend to do and how this will affect you

Our proposed changes to how we regulate, along with the UK Government's proposal to give you greater choice, mean you will finally have the power to tell your water and sewerage supplier that you will switch to another if you do not get the service you want. This will give you a much greater say over the type and quality of service you receive.

For example, if your business has a number of sites, you will be able to roll them under one supplier if you wish. We know from examples in Scotland, through the creation of Business Stream, that this is of huge value to customers. Since 2008, Business Stream has saved customers like you approximately £10 million worth of water through efficiency measures. And the wider choice of value-added services such as improved water efficiency and

more efficient account management will potentially lower your administrative burden.

To make sure that what your water company delivers (and what you pay for) reflects your needs, we have required each of them to improve their customer engagement and set up a customer challenge group (CCG).

These groups will hold water companies to account as they develop their plans. If their business plans do not take customers' priorities into account, we will challenge them and require changes. If their CCGs tell us that the company has engaged well and the plans reflect what customers want, we will be more likely to accept the outcomes they are proposing to deliver and concentrate on challenging costs.

We will set binding retail controls in 2014 for non-household customers like you. This will be in the form of a default tariff – or a maximum price for a minimum level of service. The UK Government's Draft Water Bill proposes you will be allowed to choose your water and sewerage service supplier. We expect to see companies respond to the demands of more empowered customers that can choose to switch supplier if they do not get what they want.

As well as the benefits of improved retail services such as customer service operations, you will also benefit from efficiencies in wholesale services (sourcing, treating and transporting water) which will ensure more value for services you receive.

2. Ensuring a secure, sustainable supply

Water is arguably our most precious resource and 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 almost 8,000 properties in England and Wales were flooded, keeping families out of their homes for an average of nine months.

In stark contrast, in April 2012, several companies 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](#).

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 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 the UK reflect what is happening globally, which means that water is rising up the agenda worldwide. Indeed, some energy commentators have suggested that water is the new oil¹.

What we intend to do and how this will affect you

Making water companies focus on outcomes will mean they have more freedom to decide how to deliver those outcomes. This could lead to finding 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 might 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 allow water companies greater freedom to innovate and find more sustainable solutions to meet demand, while increasing resilience. We will make sure that they have the right incentives to make informed decisions based on understanding the true value of water. The wholesale price

controls we are putting in place will encourage them to manage water resources more sustainably so that your supplies are more secure – especially during droughts.

We will encourage innovation by removing regulatory barriers, which will lead to more sustainable approaches. We will:

- treat companies' operating expenditure (opex) and capital expenditure (capex) the same way, so that they are more likely to choose the best solution rather than the traditional capital (and carbon) intensive option;
- encourage efficient water trading across company boundaries; and
- create the abstraction incentive mechanism (AIM) to reward companies that source water from where it does not damage the environment – and to penalise them if they take it from where it does.

3. Supporting our economy in tough times

Efficient and effective companies are good for the economy. Yearly turnover in the water and sewerage sectors is currently £10.5 billion and more than £108 billion has been invested over the past 24 years. Each year, the sectors spend about £4 billion on improving services for customers and enhancing and maintaining the environment.

We need to make sure this investment continues into the future. 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 to deliver efficient and sustainable solutions for the long term that evolve with your business, without adding to your bottom line.

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. As your business grows and changes, your reliance on water may change. Our framework will provide water companies with greater flexibility to respond to your needs. Giving you a choice of water and sewerage service supplier will support your organisation's growth by driving down input costs, helping you become more competitive.

Significant investment is still needed in the sectors to ensure they are able to serve you properly. To address this, we are using targeted incentives to encourage water companies to improve efficiency and customer service, which will help boost innovation but still keep costs fair.

This will mean better solutions for you, at an affordable price. Our regulatory reforms, and the retail choice proposed in the Draft Water Bill, could deliver nearly £500 million of net benefits to the economy. And another £2 billion of benefits could come from the

¹ Forbes magazine, 3 May 2012

draft Bill's proposed reforms to upstream water management, supported by the changes we are proposing in our framework.

Conclusion

It is essential that the sectors are 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 sectors and that 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

'Water retail services competition in England and Wales. Still Hobson's choice?' Policy Exchange, July 2011

'Involving customers in price setting – Ofwat's customer engagement policy statement', Ofwat, August 2011

'Future price limits – statement of principles', Ofwat, 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

'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

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



Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7699
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gsi.gov.uk

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