

Setting price controls in 2014

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

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Delivering sustainable water

As 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 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;
- 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

In 2011, the Welsh Government published its '[Strategic Policy Position Statement on Water](#)', which set out its key priorities for

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.

the water sector. This follows its 2010 'Programme for Government' and builds on other strategy documents that focus on driving forward sustainable development across Wales.

The Welsh Government's priorities for the water sector in Wales include:

- keeping bills at affordable levels by allowing choice of charging options, protecting vulnerable groups and reducing bad debt;
- putting customers at the heart of the water sector in Wales and reducing the regulatory burden; and
- delivering a higher water quality

environment as well as meeting European environmental obligations.

Our proposed framework supports these priorities and will:

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

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 service can be complex. Companies with a number of outlets are often treated as different customers, 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.

In England, the UK Government has decided that part of the way to address this problem is to give non-household customers the ability to choose their water and sewerage service supplier. This will enable customers to negotiate solutions that meet their business needs. The Welsh Government is committed to delivering effective results for non-household customers in Wales, and the 'Water Strategy for Wales' will set out options for how this will be achieved.

What we intend to do and how this will affect you

We will regulate bills to business customers in Wales in a way that is broadly similar to how we regulate in England. We will set a

separate binding retail control for non-household customers that will allow us to target our regulation better.

To ensure your bills remain fair, we will set a default tariff – or a maximum price for a minimum level of service. Water companies will then be free to respond to customer demands for different, innovative tariffs or services. To bring the water sector into line with others, companies will no longer be able to automatically increase the retail part of your bill – which reflects the costs of serving you as a customer, like sending you bills – by inflation each year (although wholesale costs will continue to be index-linked to the Retail Price Index, or RPI, to keep the cost of finance low). Water companies will then be free to respond to customer demands for different, innovative tariffs or services.

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 their 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.

Because you will not be able to choose supplier, we will continue to drive improved services to business customers in Wales through targeted regulation. For example, each year we score and compare water companies' performance on things like:

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

This is our service incentive mechanism (SIM). We will continue to use a form of SIM in Wales for non-household customers. We will also give an efficiency challenge to non-household retailers, to encourage them to drive their costs down.

Your business will also benefit from efficiencies in wholesale services (sourcing, treating and transporting water), which will ensure more value for services you receive and that your money is spent where it is needed most.

2. Ensuring a secure, sustainable supply

The Welsh Government recognises that water is one of our most precious and valuable resources. 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 imposing restrictions on the volume of water their customers could use. These drought conditions were caused by exceptionally low ground water 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 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. Many of these are based on legacy agreements that do not necessarily reflect the true value of water.

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 oil¹.

What we intend to do and how this will affect you

Making water companies focus on delivering outcomes their customers want will mean they have more freedom to decide how to deliver those 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.

The Welsh Government supports demand management solutions, including water trading. As part of that, 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, including how best to meet supply and demand pressures. 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 companies 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 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, the Welsh water companies spend about £350 million 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.

¹ Forbes magazine, 3 May 2012

What we intend to do and how this will affect you

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.

We are creating an environment where water companies are better able to serve you, while still keeping costs fair. Our targeted retail price controls will ensure companies seek efficiencies, and are encouraged to deliver more innovative solutions. This approach is aimed at keeping input costs down and supporting growth.

This will mean better solutions for you, at an affordable price. Our retail reforms, alongside retail market reform in England are estimated to deliver £500 million to the UK economy². Our upstream reforms (like supporting water trading that recognises the true value of water) could help deliver another £2 billion of benefits across England and Wales.

And to make sure 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 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

[‘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

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



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