



# Small companies workshop

Room 104, Ofwat, 7 Hill Street, Birmingham B5 4U  
Tuesday 26 November 2013  
10.30 am to 12.30 pm



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# Small companies workshop genda

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10. 0

10.

11. 0

12.2

12.30 Lunch



# Small companies workshop

## List of attendees

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## Small companies workshop

26 November 2013

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### Outline of the day



1. Purpose of today's workshop
2. Small company service incentive – why we need one and what it might look like
3. Group discussion
4. Water trading and water trading incentives – whether and how they might apply
5. Group discussion
6. Next steps and close
7. Lunch

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## Purpose of today's workshop



In the methodology statement, we committed to considering **developing a small company service incentive**

We also confirmed that we would address **whether and how we apply water trading and water trading incentives to small companies** when we consult on the detailed form of service incentive

Information notice 13/18 set out that **the consultation would take the form of a workshop**

**Purpose of this workshop** is therefore to discuss:

1. The proposal to set a **service incentive** for small companies for 2015-20
2. The application of **water trading and water trading incentives** to small companies for 2015-20

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## Consulting all small companies

As well as the larger companies, there are six companies who are **subject to different regulatory arrangements due to their size –Cholderton and the five ‘new appointees’**

Due to the **similarity in size**, we classify them as **‘small’** companies

And because of the desire to **take a consistent approach**, we are consulting all small companies together on these issues rather than separately

Company	Total number of connected customers	Household	Non household
Cholderton	730	700	30
Albion	732	697	35
IWN	2,063	1,970	93
Peel	256	236	20
SSE Water	3,666	3,639	27
Veolia Water Projects	851	723	128

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Small company service incentive

Dan Mason/Joe Sunderland

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## Structure of this session



In this session, we will cover:

What we **said in the methodology** about developing a small company service incentive, and **why**

The **characteristics of a good incentive**

The **incentives and tools at our disposal**

What **might be a rational starting point for the development of a small company service incentive**

What **information the companies should collect**

Proposed **small company incentive**

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## What we have said so far... and why



In the methodology statement, we confirmed our **intention to consider the development of a small company service incentive**, because:

**None of the small companies have been subject to a service incentive**

This lack of information from small companies creates a risk that we have **no sight of underperformance**

We have **no concrete data or evidence on customer complaints for small companies** – only NAVs subject to GSS regulations

We therefore consider that including a service incentive for small companies **can help to drive improvements in customer service and is necessary to provide a route to redress for unhappy customers**

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## What makes a good incentive?



In the future price limits discussion paper 'The role of incentives for regulating monopoly water and sewerage services in England and Wales' we set out our view that a **good incentive** should:

Have a **clear aim**

Be **proportionate** to its aim

Be **clear and transparent**

**Minimise unintended consequences**

Be **robust** to change and **adaptable**

We also consider in this context that the incentive should be **consistent across the small companies**

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## What types of incentives and tools are at our disposal? I



There are a **broad range of incentives** of relevance to economic regulation:

**Financial**, in terms of fines or rewards based on performance

**Reputational**, in terms of how the company (and its staff) performs (can also be comparative against other companies)

**Procedural**, in terms of the extent to which the company is subjected to regulatory burden

Regulators use a **range of tools** to deliver the outcomes they seek

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## What types of incentives and tools are at our disposal? II



In this context, we believe that the **reputational** incentive will provide the strongest driver for improvements in service

This is because:

**Condition B is suspended for new appointees**, thus meaning that **financial incentives would be problematic to apply in practice**

These small companies already receive a **'lighter touch' regulatory approach**, and so **procedural incentives would not be as strong**

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## What might be our starting point? I

Option	Customer benefits	Burden	Feasibility/consistency
Option 1: Do nothing	▼ <b>Low</b> – No incentive to improve service performance	▲ <b>Low</b> – No additional burden	▲ <b>High</b> – No change
Option 2: Simple information requirement	▼ <b>Low</b> – Relatively weak incentive (no financial or procedural and weak reputational)	■ <b>Medium</b> – Some additional burden	▲ <b>High</b> – Implement via Condition M (provision of information)
Option 3: Full SIM-style incentive	▲ <b>High</b> – Strong incentive (financial, reputational)	▼ <b>High</b> – Significant additional burden given quantitative and qualitative data requirement	▼ <b>Low</b> – Financial incentives problematic for NAVs (Condition B suspended) and 'no worse off' test. Qualitative element problematic given sample sizes
Option 4: Simplified SIM-style incentive	■ <b>Medium</b> – Relatively strong incentive (reputational)	■ <b>Medium</b> – Some additional burden	▲ <b>High</b> Implement via Condition M (provision of information)
Option 5: Alternative procedural incentive	▼ <b>Low</b> – Relatively weak incentive (procedural)	■ <b>Medium</b> – Some additional burden	▼ <b>Low</b> – Procedural incentives problematic for CHL (simplified PR already, with no RBR)

▼ = strong negative impact

■ = moderate impact

▲ = strong positive impact 11

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## What might be our starting point? II



Natural starting point is therefore a **modified version of SIM** – comprises two aspects of customer service delivery and has **successfully driven improvements in customer service during 2010-15 at larger companies to facilitate valuable comparison**

A **quantitative score** which is based on the number of written complaints and phone contacts a company receives

A **qualitative score** which is derived from a consumer experience survey of consumers who have had direct contact with their company

Although we consider SIM to be disproportionate, we will **use the components of it as our starting point** for consideration of the data small companies should collect

It is proposed that, due to the low number of customers served by small companies, the small company incentive is **based on quantitative data only**

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## So which parts of the SIM are relevant to small companies?

Criteria set out previously on slide 8 used to consider each component

Quantitative SIM component		Relevance/application to small companies
All lines busy	✗	Consistent across small companies Not proportionate to small companies (eg. CHL – one person operates the company phone)
Calls abandoned	✗	Consistent across small companies Not proportionate to CHL – could distort results if only one person available – not transparent
Phone contacts as a result of service failure	✓	Consistent across small companies Proportionate Is clear and transparent
Written complaints	✓	Consistent across small companies Proportionate Is clear and transparent
Escalated written complaints	✗	Not consistent across small companies or proportionate – CHL has only one person dealing with regulatory issues = no escalation
CCWater investigated complaints	✓	Consistent across small companies Proportionate Is clear and transparent

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## Proposed small company service incentive I



Propose to use adapted version of SIM quantitative score

Companies to publish this data and provide it to us

Score to be calculated as...

We would seek to make this consistent with any changes to SIM for larger companies (for example, all forms of contact, including emails and social media)

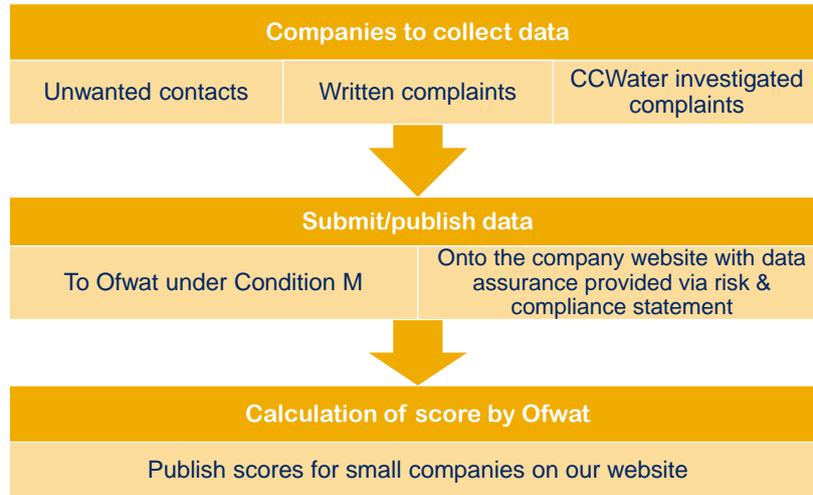
$$\begin{aligned}
 & [\text{Unwanted contacts} \times 1] \\
 & \quad + \\
 & \quad [\text{Written complaints} \times 5] \\
 & \quad + \\
 & [\text{CCWater investigated complaints} \times 100] \\
 & \quad \div \\
 & [\text{Connected properties} / 100]
 \end{aligned}$$

We would publish on a regular basis (annual basis to mirror SIM)

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## Proposed small company service incentive II



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## Questions for discussion



1. Do you agree with the proposal to apply a service incentive for small companies?
2. Do you agree with the proposed scope of the service incentive?
3. Are there other ways that we could incentivise improved performance in this area?
4. Do you agree with the proposal to publish comparative data on service performance?

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## Water trading incentives and small companies

Jon Ashley

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### What we have said so far...



In [our methodology statement](#) we said:

“In relation to transactions with new appointees, we will address whether and how we apply water trading incentives when we consult separately on the detailed form of the service incentive for new appointees”

In [information notice 13/18](#) we said:

“We will consult on applying water trading incentives at our workshop with small companies in November 2013”

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## The benefits of water trading

We want to promote interconnection because there are:

### Financial benefits

Cost savings for customers and companies

### Environmental benefits

Water will generally be moved from areas of relative plenty to areas of relative scarcity

### Resilience benefits

Providing more sources which can act as alternative supplies to customers

The Government has expressed its desire to promote interconnection in the Water White Paper and the Government's Water Bill (for companies wholly or mainly in England)

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## Why isn't more water trading happening?



### Economic issues

5-year return for bulk supply exporters

Importers dislike the treatment of imports as operating expenditure (opex)



### Regulatory issues

Regulatory processes do not emphasise trades

Lack of published information

Uncertainty over future abstractions



### Cultural issues

Risk aversion

Culture favours engineering over contracts

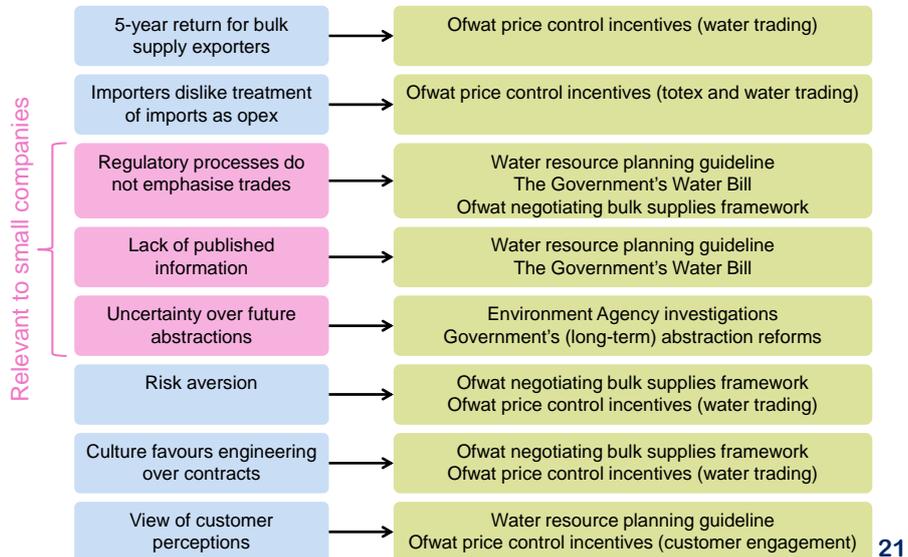
View of customer perceptions

↑  
Relevant to small companies

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## How are we addressing the barriers to water trading?



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## Export incentive



### Purpose

To encourage companies to export water where it is economic to do so

### Description

Companies will retain 50% of lifetime economic profits (that is, profits over and above the normal return on capital invested) from **new** exports with customers benefitting from the other 50%

### Delivery

The incentive will be paid retrospectively at the 2019 price review (and possibly at the 2024 price review as well)  
A company must demonstrate compliance with an Ofwat-approved trading and procurement code

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## Export incentive and small companies



### **We are minded not to apply the export incentive to small companies**

This is because:

Small companies retain 100% of any economic profits generated by an export (that is, more than the 50% export incentive for larger companies)

The export incentive is designed to work alongside the totex menus which do not apply to small companies

**Do you agree with our proposal not to apply the export incentive to small companies?**

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## Import incentive



### **Purpose**

To encourage companies to import water where it is economic to do so

### **Description**

Companies can recover the cost of a **new** import through the totex menu plus an import incentive equal to 5% of the costs of the water imported under new agreements

### **Delivery**

The incentive will be paid retrospectively in the 2020-25 price control

A company must demonstrate compliance with an Ofwat-approved trading and procurement code

We are only committing to making payments for the 2015-20 period

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## The import incentive cap



Import incentive payments will be capped at 0.1% of the importer's water activity turnover in any year of the control period. This is to protect customers

For small companies 0.1% of annual water activity turnover ranges from about £150 a year to about £2,500 a year

This import incentive cap for the small companies would be from around 10p to £3.50 per customer a year

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## Import incentive and small companies



**We are minded not to apply the import incentive to small companies**

This is because:

It is not clear small companies need an incentive to import water given how many of their sites are served by imported water. So customers would be paying for new imports that would have happened anyway

The size of the import incentive payments would be very small due to the import incentive cap

**Do you agree with our proposal not to apply the import incentive to small companies?**

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## Trading and procurement codes



Trading and procurement codes are needed to ensure that incentives are only available for efficient trades.  
(Note: These are different to the codes relating to bulk supplies in the Government's Water Bill)

Requirements and advice for the trading and procurement codes are in appendix 3 to the methodology statement

There are two main steps for a company if it wants to claim an import and/or export incentive:

**Step 1** – a company must have its trading and procurement code approved by Ofwat

**Step 2** – a company must operate consistently with and demonstrate compliance with its approved trading and procurement code

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## Trading and procurement codes and small companies



Companies are not required to comply with Ofwat-approved trading and procurement codes unless they want to receive an export and/or import incentive

**We would encourage small companies to adopt trading and procurement codes voluntarily**

This is because:

The codes would contain sensible principles about how to procure imports or trade exports – to the benefit of the company and its customers

The code approval process will be light-touch

**Do you agree with our proposal to encourage small companies to adopt trading and procurement codes voluntarily?**

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## Large companies that trade with small companies



**We are currently minded to apply the export incentive and import incentive to large company trades with small companies**

This is because:

The export incentive will be negligible for large company exports to small companies because they usually involve regulated prices (such as a large user tariff)

The import incentive will encourage large companies to take imports from small companies as well as large companies

**Do you agree with our proposal to apply the export incentive and import incentive to large company trades with small companies?**

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## Questions for discussion



1. What are your views on applying the export incentive to small companies?
2. What are your views on applying the import incentive to small companies?
3. What are your views on small companies voluntarily producing and complying with their own trading and procurement codes?
4. What are your views on applying the export and import incentives to large companies when they trade with small companies?

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## Next steps

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## Next steps



1. We will consider all the points made at this workshop
2. Present a proposal to Ofwat Board in February 2014
3. Issue an information notice in spring 2014
4. Companies to begin collecting data in April 2014 to mirror incumbents and revised SIM (for service incentive)

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