

Amgylchedd a Datblygu Cynaliadwy
Environment and Sustainable Development



Llywodraeth Cymru
Welsh Government

Sheila Miller
Price Review Programme Team
Ofwat
Centre City Tower
7 Hill Street
Birmingham
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Our Ref/Your Ref:

6 February 2014

Dear Sheila

The Welsh Government welcomes the chance to respond to the Ofwat consultation on the Service Incentive Mechanism (SIM) for 2015 onwards.

Overall design of the incentive

Q1 Should the SIM focus on incentivising innovation and out performance or bringing poor performers up to an acceptable level?

It is our view that the SIM should incentivise some combination of both. We note your comments that further frontier improvements should only be incentivised where there is compelling evidence to demonstrate cost benefits. Whilst we recognise that Dŵr Cymru Welsh Water performed moderately well, there are some areas where we believe that Welsh customers are not receiving as high a standard of service as they should be able to expect by comparison to some other companies. Your consultation document refers to specifically to customer satisfaction in relation to supply interruptions and sewer flooding and these are areas where we would like to see further improvement.

Q2 Views on whether and how the SIM should be used to incentivise service quality throughout the value chain

As our response to Q1 would demonstrate, we concur with your view that the SIM should continue to use service measures that pick up issues that reflect both wholesale and retail activities and outcomes. We also agree with your reasoning and your proposal that companies should be allowed to develop 'internal contracting' arrangements as they see fit.

Detailed design questions

Q3 Design issue 1 – symmetric or asymmetric incentive?

The Welsh Government has been supportive of the SIM and the way it has worked since it was introduced. We are therefore most inclined to support **Option 1**, which is to retain the current asymmetric structure of incentive as this has worked well.

We would strongly disagree with your pursuing **Option 2**, which we would consider a purely punitive approach and which would be unlikely to drive improvements or to encourage best possible performance. Pursuing this option might only serve to promote ‘good enough’ performance by the companies in relation to those elements of the business whose benefits are less obvious to customers but are nevertheless in accordance with our policies in relation to Sustainable Development and Integrated Water Management.

With regards to **Option 3**, the consultation document does not set out any benefits to be obtained from pursuing a symmetric incentive. Dependant on the detailed design of the structure, such an approach might have the potential to deliver certain benefits in terms of out performance but in the absence of further detail about what those benefits might be the Welsh Government would prefer not to endorse this option.

We agree with your reasoning in relation to not giving further consideration to an asymmetric structure with more upside than downside incentive.

Q4 Design issue 2 – magnitude of financial incentive

The Welsh Government is in agreement with your preferred approach, which is to broadly maintain the current level of financial exposure under the SIM.

Q5 Design issue 3 – balance of qualitative and quantitative measures

The Welsh Government is broadly in agreement with your preferred approach, which is to retain both types of measure with some rebalancing over time to greater reliance on qualitative measures as may be appropriate. This would be the approach suggested at **Option 2** but we would not wish to see the weight move so dramatically as to a potential 75/25 balance in favour of qualitative measures. As stated in the consultation document, the greatest variation across companies’ performances is against the quantitative criteria.

On the matter of the comparisons made on the basis of quantitative measures, whilst it might be a matter for each company (and for each company’s Board) to ensure that its systems and processes generate information in the correct manner, the Welsh Government is conscious that there is the potential for some companies to be more rigorous or more scrupulous in how they choose to classify customer transactions than others might choose to interpret them. This relates to the issues covered by Q6 below and we would consider it desirable for Ofwat to build safeguards in this area, as far as possible, to avoid the potential for greater transparency over complaints handling by some companies to lead to perverse results, (i.e. whereby such companies could be penalised for better reporting despite tackling customer issues more effectively).

Q6 Design issue 4 – detailed design of the qualitative and quantitative measures

The consultation document groups the components of the current and potential SIM designs under three broad options. The Welsh Government is most inclined to support retaining the current overall SIM design with the following additions:

- to add unwanted contact from all media types to the consideration of unwanted phone calls
- removing the notice period for conducting a survey

With regard to Ofwat's choice of preferred option, we do not agree that removing phone availability metrics would necessarily lead to improved reporting accuracy around the quantitative data, or conversely that any requirement to provide such data should in any sense excuse or explain the provision of poor quality data. We regard the collection of these metrics as an important indicator of how customer complaints are handled, especially as this is often the first time that a customer will have any direct contact with their company.

We would also prefer that transactional questions are retained as this can provide an indicator of how well contacts are handled at various stages (such how many instances of contact are required to resolve an issue) and could be used to help inform where specific aspects of the customer contact experience might be streamlined or improved.

Q7 Design issue 5 – use of absolute or relative performance

The Welsh Government would prefer the implementation of **Option 1** which is to retain the current relative incentive structure.

Q8 Design issue 6 – non-household SIM design for Wales

The Welsh Government would prefer the implementation of **Option 1**, which is to exclude the Welsh non-household SIM scores from the determination of household incentive payments, but to determine the incentive payments for the non-household businesses by reference to how they rank alongside the household SIM businesses. This naturally links in with our supporting Ofwat's proposal to use the same set of qualitative and quantitative measures as in the household SIM for the design of the non-household SIM.

With regard to the question of sample size issues, of the suggestions given to address these the suggestion of surveying all non-household customers (rather than just those that contact the company) is the one that we would consider the most likely to provide an accurate and useful representation of performance. Combining samples across years might be useful for showing performance over time (to illustrate improvement or decline) and the frequency of surveys is an important issue but this would seem to be the one that most appropriately and directly tackles the issue of sample size.

Conclusion

We are grateful for this opportunity to comment upon the proposed SIM design for the period from 2015 onwards, particularly given the differences that will exist between England and Wales and the need to take these differences into account. As you are aware, we will soon be publishing our draft Water Strategy for Wales which will set out at a high level some of the ways in which we are seeking to improve water and sewage services, for both businesses and households in Wales. I am grateful for the contribution Ofwat makes to

help inform our evidence base and I am keen that we should continue to enjoy the productive relationship that exists between Ofwat and the Welsh Government.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Prys Davies', written in a cursive style.

Prys Davies

Deputy Director: Energy, Water and Flood