

# Information notice

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## 2014 price review – non-household customer engagement ahead of draft determination representations

This information notice sets out our initial observations on incumbent companies' proposals for their non-household retail price controls. This is ahead of our draft decisions ('determinations') on 29 August 2014, which will include the non-household retail price controls for all companies. This is part of our 2014 price review.

We are giving this feedback to companies now to enable them to consider the issues we raise and address them ahead of 3 October 2014. This is our deadline for all stakeholders to give us their views ('representations') on our draft determinations.

Addressing the issues we raise may require some companies to do more work in speaking with and listening to ('engaging') with their non-household customers.

### Background

The 2014 price review is our process for setting the price and service packages ('price controls') that each incumbent company must deliver over the five years

between 2015 and 2020. We are setting up to four price controls for each company. One of these is for the retail services that companies deliver to their non-household customers (the 'non-household retail price control').

In '[Setting price controls for 2015-20 – final methodology and expectations for companies' business plans](#)' (our 'methodology'), which we published in July 2013, we confirmed that we would set non-household retail price controls that offer non-household customers a 'backstop' level of protection on service and price. This takes account of the ability of non-household customers in England to choose their supplier from April 2017.

We found a number of issues with companies' non-household retail price control proposals when they sent us their business plans in December 2013. So we announced that we were removing the assessment of these proposals from our main checks of their plans (our 'risk-based review'). We set this out in '[IN 14/01:](#)

[Adapted approach for default tariffs](#)', which we published in January 2014.

In '[Setting price controls for 2015-20 – guidance for companies on producing default tariffs](#)', which we published in April 2014, we provided companies with further guidance to help them develop their non-household retail price control proposals. This was after we:

- reviewed the companies' proposals and their supporting models; and
- engaged further with the companies through an industry workshop.

All companies sent us their revised proposals by 27 June 2014.

### Variation across the industry

We have reviewed each company's revised proposals, and have observed significant variation across the industry in how companies have approached their non-household retail proposals. While a variation in approach is not a concern in itself, it can make

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water sector in England and Wales.

identifying any anti-competitive proposals extremely difficult.

For example, the average gross margins per customer for unmetered water customer types that companies proposed as part of their June submissions are shown in figure 1.

This shows that there is significant variation across the industry, with a variation of more than 100% between the upper and lower quartiles – although some variation is to be expected, as companies have different cost structures and customer segmentations.

Companies are ultimately responsible for ensuring that they comply with their duties and obligations, including competition

law – observing such variation in approach could make it difficult for a company to be confident that it is indeed compliant.

### Expectations for draft determination representations

On 29 August, we will publish draft determinations that will include the non-household retail price controls for all companies. Companies will then have until 3 October to provide us with their representations on our draft determinations. This is ahead of publishing our final determinations for all companies in December 2014.

Below we set out some general expectations we have for the information that companies will include in their representations.

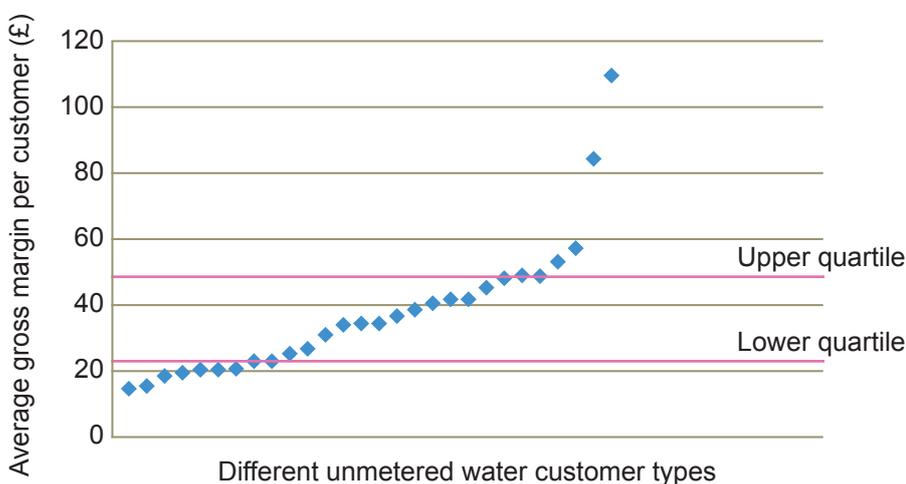
### Responsibilities of the companies

It is the companies that will ultimately bear the consequences of any infringement if their cost allocations or tariffs lead to breaches of:

- competition law; or
- their other duties and obligations, such as their licence obligations.

For example, the penalty for breaking competition law can be up to 10% of a company's group turnover.

Figure 1 Average gross margin per customer (unmetered water)



**Note:** The graph omits one proposed customer type with a gross margin of over £250 per customer, to help enable a graphic comparison between most of the data.

### Potential changes to the length or form of the non-household retail controls

Some companies may feel confident that they have developed their non-household retail proposals in a very robust manner. So they may feel entirely comfortable managing any compliance risks associated with their resultant average revenue controls for the five years from 2015 to 2020.

Other companies may not be so confident. So they may appreciate the benefit of having further time to consider and address any issues associated with their cost and net margin allocations ahead of the opening of the non-household retail market in April 2017.

In their representations on our draft determinations we invite companies to consider whether they would prefer for us to:

- set their non-household retail price control for five years; or
- change the form of the control in some way that would allow them greater time to consider and address any issues.

This is consistent with our stated expectations that companies must own their business plan proposals and any associated compliance risks, including under competition law.

We expect our invitation will result in different requests from individual companies across the sector. We are not necessarily expecting a common, sector-wide solution to emerge from this feedback.

Companies that are comfortable with their proposals may prefer to set those controls for five years as we originally envisaged in our methodology. Others may prefer to seek:

- a shorter control – for example, one to two years – in order to give them further time to develop their cost and net margin allocations; or
- a different form of reopener that may, for example, allow changes

to their price control as part of an overall five-year settlement.

We also consider that it is important to understand whether customers would wish for average revenue controls based on companies' current proposals to remain in place until 2020. So, in companies' representations, we would expect to see evidence that they have engaged with their customers about the possibility of reopening their non-household retail price control within the next five years.

### **Evidence of engagement with non-household customers**

We will set out in our draft determinations where we have particular concerns for individual companies. But we want to provide companies with the maximum time to carry out any necessary additional customer engagement.

As a minimum, we would expect to see evidence that:

- each company has engaged with its [customer challenge group](#) and ideally local non-household customer groups as well, on potential options to change the length or form of control;
- there is customer support for the structure of its proposed average revenue controls and associated default tariffs; and

- revenue levels appear acceptable to those customers.

### **Next steps**

We are publishing this information notice now to help give companies time to engage with their customers and consider the need for any reopener arrangements ahead of the 3 October deadline for representations.

### **Enquiries**

If any company has any questions about the content of this information notice, they should contact their allocated portfolio lead.

If any other stakeholders have questions about this information notice, please send them to [price.review@ofwat.gsi.gov.uk](mailto:price.review@ofwat.gsi.gov.uk).

## More information

[2014 price review web pages](#)

[Customer challenge group web pages](#)

[‘Setting price controls for 2015-20 – guidance for companies on producing default tariffs’, April 2014](#)

[IN 14/01: Adapted approach for default tariffs, January 2014.](#)

[‘Setting price controls for 2015-20 – final methodology and expectations for companies’ business plans’, July 2013](#)

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