

# Setting price controls in 2014

A briefing note for household customers in England

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## Delivering sustainable water

**A**s 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 to you during each of the five years from 2015 to 2020. We have developed our price limits methodology framework through extensive consultation with:

- customers;
- the 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

We want the needs of customers like you to be at the heart of water companies' business strategies. This is in line with Government thinking and is also a key part of

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.

our long-term plan for sustainable water and sewerage sectors.

Our proposed framework will:

- help deliver you **a better service**;
- ensure **a secure, sustainable supply**; and
- help **deliver value in tough times**.

### 1. A better service for you

We are living in tough economic times. We know household income has fallen, in real terms, by about 5% since 2010, while bad debt in the water and sewerage sectors currently adds £15 onto every customer's bill each year. We also know that average household

water and sewerage bills have gone up significantly since 2010 – broadly in line with inflation but by more than 10% overall. This focuses us on getting the best result for customers when we next set price controls. Customers have had little say over how their money has been spent and many have voiced frustration at the levels of service they receive from their water company.

After seven of the 20 water companies in England and Wales saw [increases in the numbers of complaints in the past year](#), the Consumer Council for Water said that these companies should not assume they can get away with poor service.

## What we intend to do and how this will affect you

We want to make sure you get the service and delivery that you deserve and value. To ensure this happens, we want water companies to take your needs into account in their long-term plans. We have required each of them to improve their customer engagement and set up an independent customer challenge group (CCG). This group will challenge companies to engage with you properly and to reflect your views and needs in their business plans. This will mean the following.

- Companies will draw up the outcomes they will deliver based on customers' views and priorities alongside their legal obligations.
- The CCGs will challenge companies, focusing on how well they have engaged with their customers, and whether their proposals reflect customers' priorities.
- We will make the final assessment of companies' proposals, and we will listen carefully to the views of the CCG when we do this.
- Where companies have listened to their customers and done a good job, we will accept their version of what they propose to deliver and concentrate on challenging costs.
- If business plans do not take customers' priorities into

account, we will challenge costs, and also require changes to make sure that customers' needs are recognised.

To bring the water and sewerage sectors in line with others across the economy the retail part of your bill – which reflects the costs of serving you as a customer, like sending you bills – will no longer rise automatically in line with inflation (although wholesale costs will remain index-linked to the Retail Price Index, or RPI, to keep financing costs low). We will challenge water companies to improve their retail businesses by reaching, or beating, the average cost to serve a household customer. This will help keep bills manageable for hard-pressed households.

We will continue to drive improved services through targeted regulation. For example, each year we score and compare companies' performance on things like:

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

The best performing companies will be rewarded while those that perform poorly will be encouraged to improve. This is our service incentive mechanism (SIM), which we will continue to use.

We will also make sure you benefit from efficiencies in wholesale services (sourcing, treating and transporting water), which will ensure better value for money for you.

## 2. Ensuring a secure, sustainable supply

Water is arguably one of our most precious resources 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-

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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 water is rising up the agenda worldwide. Indeed, some energy commentators have suggested that water is the new oil<sup>1</sup>.

### **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.

We want to encourage water companies to find more sustainable ways to meet their customers' needs, while also improving resilience. By increasing the volume of water traded between companies we will begin to get a better understanding of the true value of

this precious resource – not just economically but to us as a society and to our environment. Then companies can make better informed decisions on where to invest and how to balance supply and demand pressures.

For example, by encouraging efficient water trading across company and regional boundaries, if there is a hosepipe ban in your area while a neighbouring region has adequate supplies, companies will be better able to import water to ensure your supply is not affected.

At the same time, to make sure that this is done in a way that does not harm the natural environment, we will encourage companies to source water from where it does not damage the environment and penalise them if they take it from where it does. We will do this in a way that is similar to how we encourage service improvement. Our tool for this is called the abstraction incentive mechanism or AIM.

Together, the incentives we are putting into our wholesale price controls will encourage companies to manage water resources more sustainably and ensure supplies are more secure, while improving efficiency.

### **3. Delivering value in tough times**

Efficient and effective water companies are good for the economy. Turnover in the water and sewerage sectors is currently £10.5 billion a year, and more

than £108 billion has been invested over the past 24 years. Each year, the companies spend about £4 billion on improving services for customers and enhancing and maintaining the natural environment.

We need to make sure that this huge amount of investment can continue. But the solutions of the past are not necessarily the right solutions for the future. New, emerging challenges mean the water companies need to be more innovative to deliver more efficient and sustainable solutions, without adding to your already stretched finances.

Ultimately, it is customers who pay the price for inefficient investments or wasted water – whether it is they or the company that wastes it. They also bear the risk of higher prices or more frequent restrictions on the water they use if supplies become unsustainable in the future.

### **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. Our framework will provide the sectors with greater flexibility to respond to your needs – first by making them focus on your views in their long-term business plans. Ensuring your water company engages with you will help you get the level of service you want, for a fair price.

And we want to see your water company spending your money

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<sup>1</sup> Forbes magazine, 3 May 2012

on projects that are necessary. This is to ensure that water is used efficiently and waste is limited. For example, water trading may ease the need for projects that cost a lot of money, such as the building of new reservoirs, which will mean money is spent delivering services that are required more urgently.

In total, we estimate that our reforms to your retail service alongside Government proposals in the current Draft Water Bill will deliver £500 million of benefits to the economy. Reforming the way we manage wholesale water services – like supporting water trading that recognises the true value of water – could help deliver another £2 billion of benefits.

And to make sure that water companies can secure the investment needed to deliver these benefits, we will continue to regulate the monopoly aspects of the sectors 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 and sewerage 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

[‘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

[‘Water company complaints “rise in the south”, Which?’](#), September 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**



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