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31 January 2017

Dear David

## **A consultation on the outcomes framework for PR19**

We agree with your four priorities for the development of Outcome Delivery Incentives (Outcomes) in PR19. Outcomes should be powerful; commitments should be stretching and transparent; there should be a clearer focus on resilience.

You will know that for us the key area of debate on Outcomes has been to what extent targets should be imposed by the regulator at a cross-industry level, or to what extent performance commitments can be agreed at a local level by us through consultation with our customers and stakeholders. Inevitably, there is a continuum between these two points.

In both models however common industry measures are useful for customers and stakeholders to hold companies to account on their comparative performance. The industry has already taken the lead in producing and making available comparative information, and the common measures shown through the Discover Water website already have strong reputational incentive qualities. This in our view allows PR19 to be framed differently.

Common performance measures at PR19 should provide backstop protection for consumers rather than be the primary vehicle to deliver what customers value

Our reading of your consultation suggests:

- That there will be a greater number of common measures
- That there will be common targets on more common measures
- That these common targets will be more stretching
- That the financial incentives around these common targets will be greater than the additional bespoke performance commitments that the company proposes.



This may not be in customers' best interests because:

- Common comparative measures are often a blunt measure of customer experience
  - Consistency of reporting requires a lowest common denominator approach - for instance the use of a 6-hour supply interruption period takes no account of whether the interruption was forewarned or at what time of the day it occurs.
  - As written, they tend to exclude many of the key tangible customer experiences: the imposition of a lengthy boil-water notice, the water leak running down the road, the imposition of a hosepipe ban.
- Companies targeted with “industry leading/frontier/upper-quartile” performance on all common measures may be incentivised to deliver improvements that their customers do not value
- A weighting towards powerful common targets may crowd out more innovative customer-focused targets that customers would value more highly
- The added costs to customers created by the imposition of targets may well exceed customers' ability to pay

Given that the reputational impacts for company management of any common measures are already significant, additional financial incentives may be counter-productive if these do not reflect what customers truly value.

We also recognise that in the event that companies' engagement with customers is not extensive and robust, you will need some measures to impose as a back-stop. In such cases it may be appropriate to gear-up a greater number of common performance measures with more powerful financial incentives and more stretching targets for that particular company.

The balance of incentives should be skewed towards bespoke performance commitments rather than common targets

Companies, through continuous engagement with customers and communities, should be best placed to understand and articulate with evidence the outcomes that customers value.

Where companies have good levels of engagement, bespoke performance commitments should be the primary means of incentivising performance and the balance of financial incentives should be weighted further towards bespoke performance commitments and away from the common measures and targets.

It should also be possible for companies to provide evidence on why a stretching target based on comparative performance is not appropriate in its circumstances, or to otherwise negate the imposition of a common performance measure through a bespoke commitment that better reflects what customers value.

We should carefully consider the impact on customers of more stretching targets

The consultation takes as its starting point the view that current performance commitments are not stretching enough but this may be premature. We note that in the first year industry performance was mixed with a net penalty for water ODIs and a net reward for sewerage ODIs. This was also a year in which the weather was relatively benign and where the full impact of the imposition of the more severe upper quartile challenges has yet to be felt.

You make the point that the availability of rewards is in customers' interests as it reduces the cost of capital. By extension if performance commitments and targets are understood by investors to be skewed substantially to the downside this will also increase financing costs borne by all customers.

So while we agree that targets should be stretching and there are a number of ways that this can be achieved we need to mitigate this risk by ensuring that the rest of your price control methodology, including the assessment of efficient costs, is consistent with the approach taken on outcomes.

The variable cost of equity approach may be a helpful part of this as it will allow the overall package of measures to be calibrated against the level of ambition in the plan.

We answer your specific consultation questions in the attached appendix.

I hope this is helpful.

Yours sincerely



Phil Wickens  
Director of Regulation and Reform

## Appendix

### Wessex Water: Response to consultation on the PR19 Outcomes Framework

This response should be read alongside the accompanying covering letter.

#### Making performance commitments more stretching

##### **Q1: What is your view on the use of improved information, including comparative performance information, to make performance commitments more stretching?**

We are in favour of comparative information published on a consistent basis that holds companies to account since the consequence of this is that it holds management to account for differences in performance. Outcome performance competition between companies creates a powerful reputational incentive similar to that provided by the Company Monitoring Framework and Financial Resilience report. One consequence of this may be that performance commitments become more stretching for those companies whose performance is lagging behind.

That said it is appropriate to make performance commitments more stretching only where customers value the outcome and where this works in customers' best interests. Ofwat has confronted this issue in the past – in the mid-1990s, the DG6 – DG9 targets were essentially common performance commitments, where targets were ratcheted up until they were eventually abandoned in favour of the SIM when it was realised that they led management to focus on matters not valued by customers to achieve ever-smaller increments in performance.

Comparative information on performance stimulates company improvements and makes companies accountable to their stakeholders but companies need to have a choice between either complying with common measures or explaining why this may not be in their customers' best interests. The Discover Water website includes narratives to allow readers to be able to judge performance in an appropriate context and helps them understand that companies start from different positions.

#### *Views invited*

You asked for views on how performance could span more than one price control and how these might operate in practice. Performance commitments should be set to ensure we meet our outcomes in the longer term and should be agreed with the long-term context in mind. Whilst it is appropriate to set outcomes that span more than one price control, it is appropriate to set performance commitments within a single price control period, unless the outcome relates to a specific project with a long lead time.

**Q2: What is your view on the common performance commitments we are suggesting for PR19?**

In our view, your suggested ten common performance commitments provide a useful backstop to protect customers but we think the balance of incentives should lean towards bespoke measures that derive from companies' continuous engagement with their customers. For us the key area of debate is the extent to which targets should be imposed by you at a cross-industry level or be agreed by companies through consultation with customers, which we think would be better aligned with your vision of principles based regulation.



**Area of focus**

■ Customer satisfaction ■ Current performance ■ Resilience/future performance

You have proposed that common commitment levels could be adopted for six of the ten common measures:

- Water quality compliance
- Supply interruptions
- Internal sewer flooding
- Pollution incidents
- Water mains bursts
- Sewer collapses

With regard to statutory compliance metrics such as drinking water quality compliance and pollution incidents, it is likely that the quality regulators (DWI and EA) will expect future targets to be set at 100% or zero respectively. This implies that rewards will not be available and the measure will be penalty only with your own assessment (figure 3 in the consultation) showing that this will have the impact of driving up financing costs. It may be appropriate therefore to leave these as reputational measures and allow legislation and actions from other regulators to define the penalties. Additionally, the level of efficient costs in your cost assessment could also take companies' compliance with statute into account.

We do not think that asset health measures of water mains bursts and sewer collapses should be subject to a common commitment level. In both cases, the numbers are dependent on number of local factors including the asset age, ground conditions etc. and the historical rate of replacement and neither of the proposed measures has been subject a recent common definition review. Furthermore, all our investment to date has been targeted at maintaining a stable performance using a reference level and control limits, the limits having been established based on company-specific past performance.

With regard to your other proposed common measures, we do not think that:

- Distribution input/ leakage is appropriate for the application of a common commitment level, as these measures are specific to companies' water resource situations
- AIM is appropriate for a common commitment level as it is site-specific and only applies in a proportion of companies.

You ask whether ten is an appropriate number of common performance commitments. In our view, the number of common measures should be kept to the absolute minimum as they provide a backstop of regulation intended to protect customers. Companies will have the opportunity to continue with their existing performance commitments and design additional bespoke performance commitments.

Some of the proposed common measures apply across a number of price controls. For instance, the new common measure of resilience could apply to all four wholesale price controls, and the customer experience measure applies to all the price controls. We consider that it would be an unnecessary complication if each price control had a version of the appropriate common measures, which would potentially increase the number of common measures significantly.

We note that out of the ten proposed common measures only four are directly related to customers' experience of the services they receive, with the other six measures more focused on outputs than outcomes:

- New customer experience measure (water & wastewater)
- Water quality compliance (water)
- Customer water supply interruptions (water)
- Customer property sewer flooding (internal) (wastewater)

The measures suggested are blunt measures of customer experience, while consistent reporting requires a lowest common denominator approach. For example, a fixed supply interruption period takes no account of whether or not customers were forewarned or the time of day at which the interruption occurs – both of which will matter to customers. Secondly, the measures as written exclude key tangible customer experiences such as the imposition of a lengthy boil-water notice, the water leak running down the road, the

imposition of a hosepipe ban. Recognising this, we think that the balance of incentives should favour bespoke measures developed by companies in consultation with their customers that truly reflect their priorities.

We note that your proposed ten performance commitments are more heavily weighted towards water than wastewater, as illustrated in table 1 below.

*Table 1: common metrics and business activity*

	Water Resources	Water Network plus	Sewerage Network Plus	Sludge
1. Future customer experience measure		✓	✓	
2. Water quality compliance		✓		
3. Customer water supply interruptions		✓		
4. Water distribution input / leakage / per capita consumption	✓	✓		
5. Abstraction incentive mechanism	✓			
6. Customer property sewer flooding (internal)			✓	
7. Wastewater pollution incidents			✓	
8. Water mains bursts (asset health water)		✓		
9. Sewer collapses (asset health wastewater)			✓	
10. Possible new common measure(s) of resilience	✓	✓	✓	

This imbalance in common measures could be addressed by adding in discharge permit compliance as a possible wastewater measure and/ or percentage sludge compliance as a sludge measure.

More detailed comments on each of the possible common measures are provided in the following sections, together with more general comments about their coverage. At the end of our response to this question we provide a summary of our views on the common measures and the potential application of comparative assessments.

1. New customer experience measure

We believe that it is appropriate to introduce a new customer experience measure with rewards and penalties linked to the company’s ranking that builds on the SIM, which has been very successful in driving improvements to customer experience and service and is a well-established comparative performance measure.

We comment on the design and scope of your proposed new measure in our response to question 6.

2. Water quality compliance

Confidence in drinking water quality is a key priority for customers and for water companies and for this reason a common measure on water quality compliance is appropriate. Whatever measure is adopted, we believe it should take account of key tangible customer

experiences such as the imposition of a lengthy boil water notice. We would suggest that, for PR19, Ofwat should:

- Create a composite water quality index based on the four existing indices of process control, disinfection control, distribution maintenance and reservoir integrity, weighted by the number of tests used for each index, to be used as a comparative measure at PR19
- Adopt the DWI's new Compliance risk index as a reputational measure at PR19, with a view to developing it as a comparative measure for PR24.

The industry, Ofwat and the Drinking Water Inspectorate (DWI) should work together to identify the best measure of drinking water quality but we make the following comments against your alternative candidates for a single measure to help you identify the best possible measure:

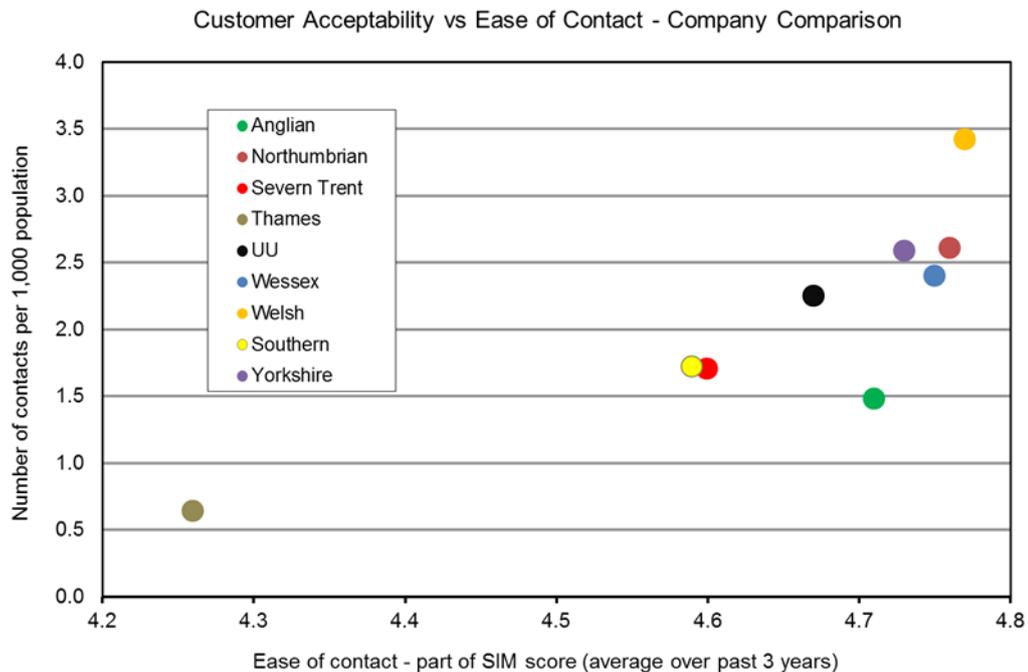
a) Mean zonal compliance

The DWI is proposing to phase out mean zonal compliance as one of its key measures, mainly because of concerns that it is not a broad enough measure of water quality. The DWI is developing a replacement measure called Compliance Risk Index but the detailed consultation on this measure has only just commenced and it is unlikely that the new measure will be sufficiently well developed for it to be used as a comparative measure at PR19 whereas mean zonal compliance is well established, with a clear definition and calculation method.

b) Water quality contacts

While this is a measure of water quality as experienced by customers, it is heavily influenced by the ease of contact with the company. If it is easy for customers to make contact (which we consider to be a good thing) there will be more contacts; conversely if it is hard to make contact there will be fewer contacts (as shown in figure 1 below):

Figure 1: Ease of contacts and resulting number of contacts



Unavoidable variations in water chemistry (e.g. upland soft water is more aggressive to iron pipes than hard groundwater) affect the number of contacts, which means there is a very large range of values for this measure across the industry – between zero and over 4 contacts per 1,000 population. Finally, we note that this measure may not be an appropriate measure because it has not been subject to a review of the consistency of definition and its application.

c) Water quality incidents

Whilst there is common agreement that it is a good thing to self-report water quality incidents, there are significant differences in approach to the notification of incidents. Furthermore making this a performance commitment could drive the wrong behaviours and incentivise companies not to self-report, which would be contrary to good practice and would make this an inappropriate measure.

You and the DWI might consider a number of other measures, including the number of boil water notices, illness contacts, number of recommendations in event assessments but none of these appear to meet your criteria of being consistent and customer orientated.

We note that, in addition to mean zonal compliance, for many years companies' performance has also been monitored by a series of performance indices, namely:

- Process control index – a measure of water company treatment performance
- Disinfection control index – demonstrating the effectiveness of disinfection and pathogen removal

- Distribution maintenance index – a measure of the performance and condition of the distribution network
- Reservoir integrity index – a check on the integrity and general hygiene at service reservoirs.

All four of these indices are used by the DWI to monitor companies' performance while the Distribution maintenance index was used by you as part of the water infra serviceability assessment in AMP5. These indices focus on company performance as they exclude failures related to customer plumbing or appliances, have a standard definition and calculation method and there is an established data set. It is for these reasons that we suggest that you consider:

- Creating a composite water quality index based on the four existing indices of process control, disinfection control, distribution maintenance and reservoir integrity, weighted by the number of tests used for each index, to be used a comparative measure at PR19
- Adopting the DWI's new Compliance risk index as a reputational measure at PR19, with a view to developing it as a comparative measure for PR24.

### 3. Supply interruptions

Your proposal to use the minutes lost per property with supply interruptions greater than 3 hours KPI as a common performance commitment shows how blunt a common performance indicator can be because the use of a fixed supply interruption period takes no account of whether customers have been forewarned or the time of day that the interruption occurred. For PR14 we proposed unplanned interruptions as our performance commitment for service failure, because we felt strongly that planned interruptions were less disruptive to customers and that our proposal was in customers' best interests but we were required to adopt the common industry standard of minutes lost total supply interruptions.

Consistent reporting results in a lowest common denominator approach which may not be in customers' best interests, if the measure adopted does not take account of the customer experience (such as discussed elsewhere, the >6 hour supply interruption which ignores the time at which the interruption occurred or whether customers were forewarned).

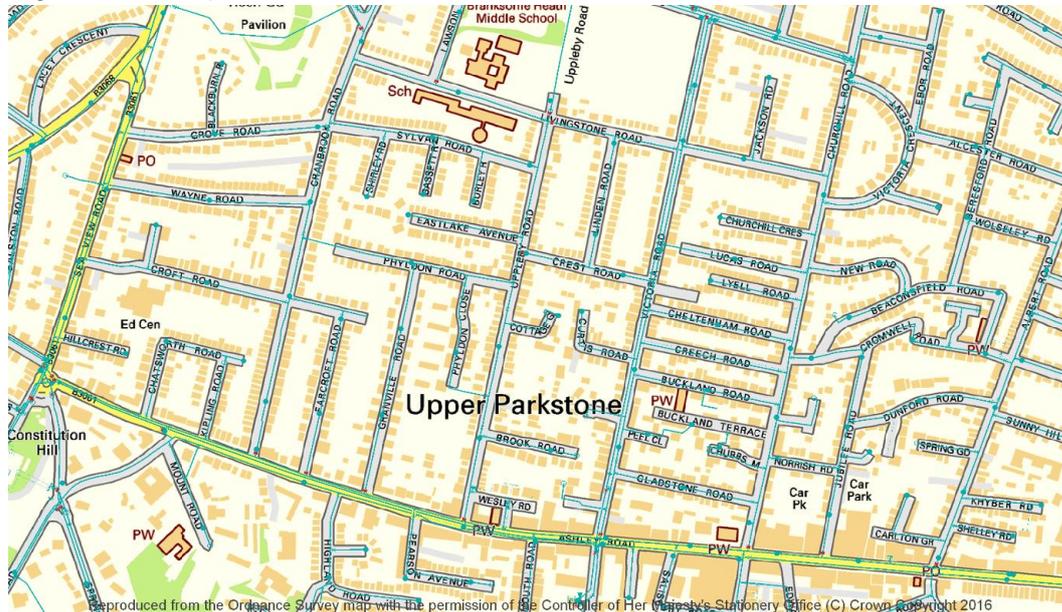
We have contributed to the ongoing reporting consistency project that would allow the introduction of a common measure for supply interruptions at PR19. You note<sup>1</sup> that network interconnectivity has a material impact on supply interruptions and we feel that the measure should be normalised by mains length per property to account for the lack of interconnectivity in rural distribution networks, or that this factor should be taken into account in the setting of ODI dead bands. Comparison of an urban and rural network should help explain why:

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<sup>1</sup> Appendix 1, page 33.

- In an **urban network**, in most cases any single pipe failure has a limited impact as it should be possible to isolate the individual pipe and maintain supplies to surrounding properties through rezoning onto adjoining parts of network (as shown in figure 2 below):

Figure 2: Example of urban interconnected network



- In a **rural network**, in many cases a single pipe failure can have a greater consequence because supplies to surrounding properties will be lost as there is no rezoning option, or the long lengths of pipework between villages and changes in topography limit the hydraulic capacity to rezone demand.

The following example of a rural unconnected network is shown without the map background (figure 3) to show the extent of areas supplied from a single pipe and with the map background (figure 4) to illustrate the long length involved between these isolated areas.

Figure 3: Example of rural unconnected network – without map background

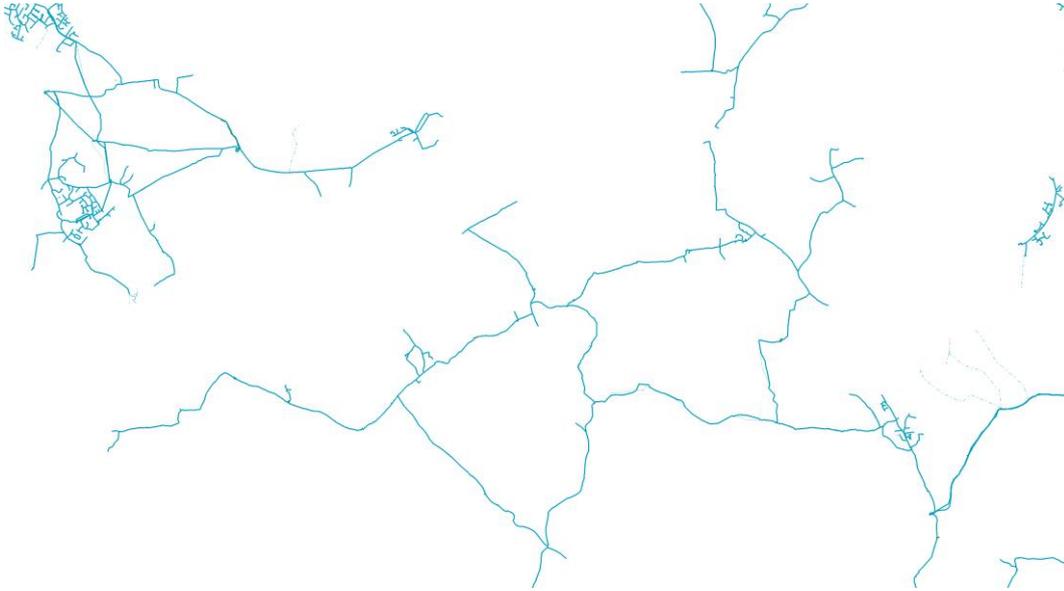
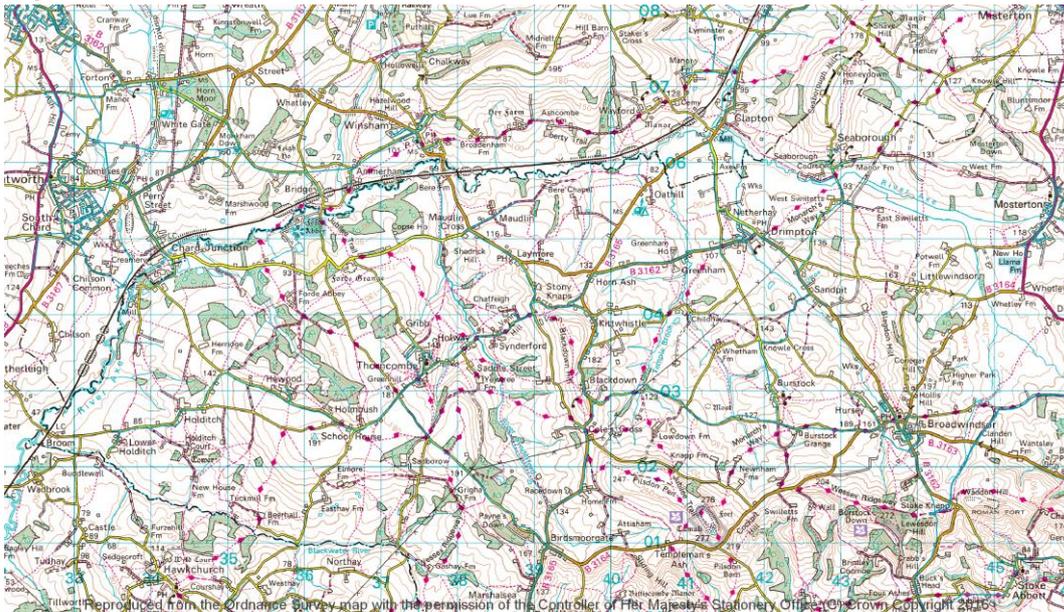
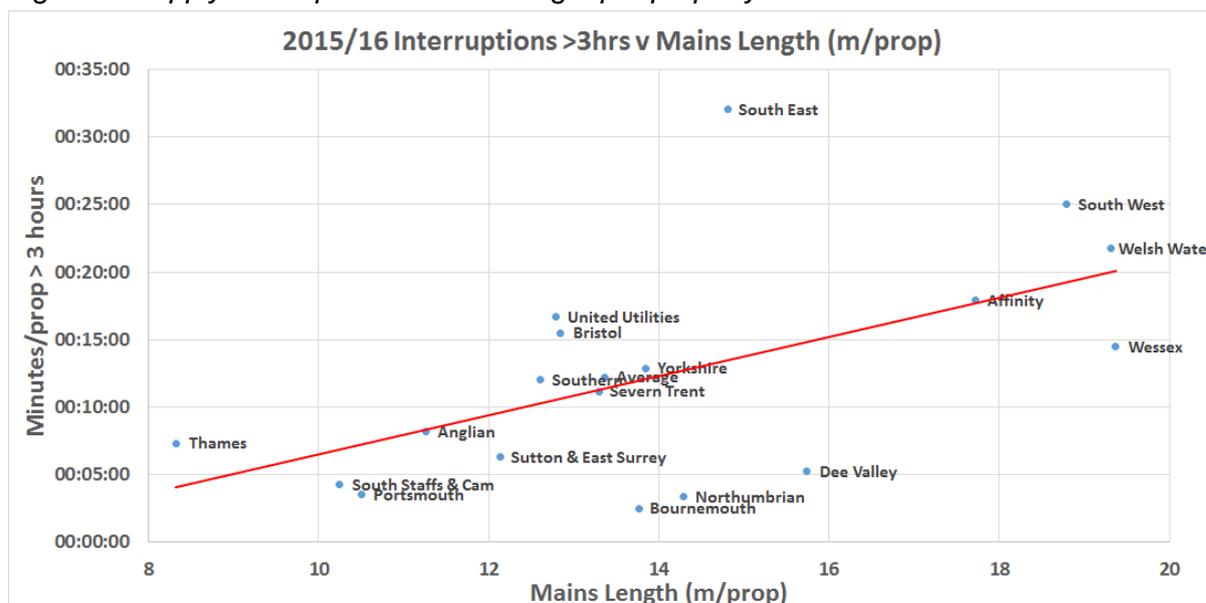


Figure 4: Example of rural unconnected network – with map background



There is a very strong correlation between supply interruptions and rurality (mains length per property) as shown in figure 5 below and we believe that any common performance commitment level should be normalised to account for this significant explanatory factor.

Figure 5: Supply interruptions v mains length per property



#### 4. Leakage

Total leakage should be a common measure because this is a concern for many of our customers although our recent SDS research indicates that leakage is less of a concern for younger stakeholders because of our active management of the problem over the past twenty years. Because of its overall importance, we do support total leakage as a common measure although our view is that this is most useful to customers if it is expressed as volume per kilometre of pipe.

The measure adopted should take account of customer experiences: customers are particularly concerned when they see water running down the road and we have therefore put in place measures to fix customer-reported leaks within a day. This might be appropriate as a common performance target although we accept that other companies may not be able to report on this at this stage.

We see benefits to customers in reporting a 3-year average that would allow companies to reduce costs by absorbing uncertainties and risks and pass on these costs in the form of reduced bills. The weather plays a significant part in determining leakage and, for this reason, we would advocate use of a rolling average commitment level rather than an annual spot value.

The UKWIR zero leakage by 2050 strategic project gives an opportunity to review comparative assessment approaches for PR24. We do not think it is appropriate to have a common performance level for leakage because each company faces different pressures in relation to their water resources position and the importance to them of demand management. It is for companies to justify their current level and proposed future targets to customers and stakeholders with relevant information from their economic level of leakage assessment and Water Resource Management plans (WRMP).

We do not support the proposal to include distribution input (DI) as a common performance commitment in AMP7 since this is a not good measure of the efficient use of water owing to the potential sudden and material impact of changes in non-household use that can occur, most commonly driven by the weather in the local area. Such changes can be difficult to forecast and are almost entirely outside of our control, which undermines this metric in setting performance commitments.

Similarly, we do not support the proposal to include per capita consumption (PCC) as a common performance commitment in AMP7. There is no current weighted average PCC methodology/ best practice that is adopted universally across the industry, which would make common performance setting difficult. The EA already monitors the PCC through the WRMP process and companies might choose this measure as a bespoke performance commitment.

## 5. AIM

Managing and reducing the impact on our local environment of abstracting water for public water supply is important to customers (and our regulators). The main way of ensuring abstraction does not have an unacceptable impact on the environment is through abstraction licencing – we have a performance commitment to achieve 100% compliance with abstraction licences each year.

Where concerns have been raised that existing licences do not provide adequate environmental protection we have, in partnership with the Environment Agency and other stakeholders, had an active programme of investigations, investments and licence changes spanning the last 20 years and counting.

The AIM can be applied at locations where the evidence for an unacceptable impact of the abstraction is not conclusive and so formal licence changes are not warranted but concerns, particularly by the local community, may still remain.

Of our more than 80 abstractions, Wessex Water has a single source, Mere, where it was appropriate to implement AIM in AMP6. The AIM at this site was included as a bespoke performance commitment with a financial penalty.

We are keen to maintain engagement with the Mere community around issues of abstraction, river flows and water efficiency into the foreseeable future. We anticipate a continuation of an AIM performance commitment at Mere once again in AMP7 although in slightly modified form to the AMP6 one. For consistency across the industry we could adopt the (normalised) performance reporting approach as detailed in the guidelines published in February 2016 and so support the inclusion of AIM as a common performance commitment.

## 6. Internal sewer flooding

Sewer flooding is one of the most distressing service failures for customers and, for this reason, at PR14 we adopted two sewer flooding performance commitments, one related internal flooding incidents due to blockages, collapses and equipment failures and another related to the overall flood risk. A proposed common performance commitment for internal sewer flooding is therefore appropriate, with the definition based on the work undertaken by Water UK to establish a common definition for reporting internal sewer flooding. The Water UK consistency project has agreed a measure for reporting internal flooding which includes both flooding incidents due to overloaded sewers (hydraulic inadequate capacity) and due to other causes e.g. blockages (FOC). Water UK are currently procuring the services of a consultant to provide additional assurance to the overall proposal.

The measure should be normalised for the number of connections – our PR14 internal flooding incident performance commitment has units of number of incidents per 10,000 properties. The June Annual Return 2011 guidance document has been used as a starting point for developing a consistent definition.

## 7. Pollution incidents

We agree with your proposal to base this on the total number of category 1, 2 and 3 pollution incidents in a calendar year normalised by total length of sewers, since this is the same measure as total sewerage pollutions used by the Environment Agency (EA) in their annual Environmental Performance Assessment (EPA). During AMP5, a joint 'Task and Finish' group comprising Water & Sewage Companies and the EA carried out considerable work to improve the consistency of pollution incident reporting and categorisation and we would support any similar work joint work with the EA on consistency should it be thought necessary.

We believe that the other EPA pollution measures should *not* be included in the comparative measure for pollution:

- (a) Percentage-self reporting as currently measured can be biased. For example, a company that successfully reduces pollutions from assets monitored by telemetry (where incidents are more likely to be self-reported e.g. CSOs and pumping stations) will find it more difficult to maintain high self-reporting levels from the remaining assets about where there is little remote information to inform the water company first as to possible problems.
- (b) Serious pollutions (category 1 & 2) are low in number and, despite the work described above to improve consistency of categorisation, the boundary between category 2 and category 3 is often very difficult to define precisely.

We note that the EA<sup>2</sup> has an expectation about pollution incidents up to 2020 being:

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<sup>2</sup> EA, letter to water companies (23 August 2013) from Paul Leinster, then EA Chief Executive, Annex 1: Expectations for operational performance of working together to protect and improve the environment

- Reducing serious (category one and two) pollution incidents, trending towards zero by 2020. There should be at least a 50 per cent reduction compared to numbers of serious incidents recorded in 2012.
- Trend to minimise all pollution incidents (category one to three) by 2020. There should be at least a third reduction compared to numbers of incidents recorded in 2012.

We expect that the EA will want still further reductions for AMP7 and it is therefore important that the comparative assessment and the EA's expectations for reductions are considered in an equitable way and that you consider whether a penalty-only incentive is in customers' best interests.

#### 8. Mains bursts

We support mains burst as a common measure and we support its use as the lead indicator for water infrastructure asset health. However, we do not support the use of a common performance target for mains bursts since these dependent on a number of factors including age of mains, local ground conditions and historical installation practices.

Setting company specific targets for reported bursts (excluding detected leaks) using a reference level and control limits approach is recommended. Discover Water reports on mains bursts but this metric has not been subject to a consistency of reporting project.

At PR14 we selected mains bursts as our performance commitment for water infrastructure asset health as we considered that this indicator best represented long term asset stewardship of our distribution network. In AMP5 our regulatory target was to maintain stable serviceability, which was defined as maintaining the performance within upper and lower limits, oscillating around a steady reference level, assessed from historical performance. Our investment planning was orientated around this objective.

The June Annual Return Table 11 mains bursts definition includes both reported bursts and detected leaks. We suggest you consider just using reported bursts and exclude detected leaks.

Setting a common performance level based on the upper quartile level or similar is not appropriate. It is not the case that customers have paid for this level of service; as indicated above our investment to date has been targeted at maintaining mains bursts stable from year to year. Companies would need a very long glide path to make significant movement in the measure, and this would require very large scale asset replacement which would have a large bill impact.

It is worth noting that there are potentially significant interrelationships between some of these measures. For instance:

- If large scale asset replacement is carried out this would have an adverse effect on the supply interruptions measure.
- In order to manage leakage in the most cost beneficial manner in the longer term it may be necessary to increase active leakage control and therefore increase the number of detected leaks, which is currently a constituent of the mains bursts metric. An increase in detected leaks would not represent a deterioration in the condition of the network, but rather the result of increased leakage activity on the assets to provide the best possible service to customers whilst maintaining bills at affordable levels.

#### 9. Sewer collapses

Sewer collapses and rising main bursts have historically been the lead indicators for sewerage infrastructure serviceability and we agree that these indicators best represent long-term asset stewardship for our sewerage network.

For very similar reasons to those set out above for mains bursts, we do not support the use of a common performance level for sewer collapses. In addition, we would make the following comments:

- There has not been a review of the consistency of reporting. We believe most companies are reporting sewer collapses against the 2011 June Return definition, which is vague – some water companies may record sewer deformation as a collapse; others may not. As companies serviceability targets were assessed based on their own historical performance, variations between companies did not matter, whereas they would if comparative assessment was applied
- The measure includes bursts on sewer rising mains as per JR11 definition.

There would be significant uncertainty and loss of historical trends if the new measure were to include collapses and bursts on transferred assets (S105A 2011 & 2016).

#### 10. Resilience

A common measure of resilience should look at companies' preparedness for unforeseen events (and service failures) as well as the customer experience when things go wrong (and the speed with which these are resolved). Companies should embed resilience measures into their standard processes and Boards should focus on the appropriateness of these measures. Comparative resilience performance measures across the sector must be informed by both the levels of service received by customers and some means of measuring business resilience maturity.

Business resilience maturity (being the capacity for identifying changes in demand, environmental pressures and risks across every element of the delivery chain) should be assessed against a standard matrix model. We are currently developing such a matrix, that we will share with you as we embed it in our business processes.

We suggest that the most appropriate measure of long-term resilience for water services would be a measure of the risk of having hosepipe bans or non-essential use bans in a particular year, which can be measured through the security of supply index, an existing established metric. The flood risk grid is our existing measure of hydraulic capacity and therefore the resilience of our sewerage network to extreme weather and is already one of our bespoke performance commitments – risk of flooding from public sewers due to hydraulic inadequacy.

Our views on your comparative measures are summarised in the following table:

*Table 2: summary of our views on your proposed comparative measures*

Measure	Definition	Commitment level and comparative assessment
1. Future customer experience measure	We consider that the current SIM approach is fundamentally fit for purpose as a measure of customer satisfaction at the transactional level – but we support changes to SIM so that we can take into account changes in the way customers communicate with us.	Feasible and should continue as a comparative performance measure.
2. Water quality compliance	<p>The DWI is phasing out its existing MZC measure of water quality.</p> <p>Our recommendation is a twin track approach of:</p> <ul style="list-style-type: none"> <li>• A basket water quality index based on the four existing indices - as a comparative measure at PR19, plus</li> <li>• The DWI's new Compliance risk index as a reputational measure at PR19, with a view to developing it as a comparative measure for PR24.</li> </ul>	Consistent definition and data is available but company rewards for performance that is not 100% are unlikely to be palatable. This would undermine the customer benefit for including such a measure as an ODI (see figure 3 in your outcomes consultation document) and could increase bills for customers.
3. Customer water supply interruptions	Current minutes lost per property, which has been subject to consistency review	Feasible, but this should be normalised by mains length to allow for company specific factors. This measure is very blunt and therefore should be used only as a backstop protection for customers in the absence of good customer engagement on appropriate targets.
4. a. Water distribution input	May introduce a conflict with duty to meet new demand and commercial use. Impact of weather is greatest impact in any one year so this may make a 5 year time period inappropriate for measurement.	Not feasible

4. b. Leakage	Leakage in volume per km of pipe should be based on a three year rolling average – this would reduce customer bills if it led to more economic expenditure. Definition reviewed under consistency project	Not appropriate to set a common target. Leakage targets should continue to be based on company specific Economic Level of Leakage.  Instead, customer-reported leaks fixed within a day could be a better comparative measure of the customer experience.
4. c. Per capita consumption	Not recommended as a cross industry level. PCC is highly weather dependent making target setting very difficult, without a common approach to normalising for the weather impact.	Not feasible or recommended. Companies have different resource positions, diverse customer bases and different weather which can explain differences in PCCs.
5. Abstraction incentive mechanism	Agreed based on industry standard method.	Not feasible as unique to companies and specific sites.
6. Customer property sewer flooding (internal)	Agreed. Measure has been subject to consistency review.	Feasible.
7. Wastewater pollution incidents	Agreed. Also monitored by EA's EPA	Feasible but need to take account of EA expectations for reductions when setting common targets.
8. Water mains bursts (asset health water)	Agreed as a measure of long-term asset stewardship, but has not been subject to consistency project. Includes detected mains leaks	Not appropriate to set targets on a comparative position as these are not measures of service qualities. Comparative performance metrics should be applied only on areas where there would be winners and losers if competition existed.
9. Sewer collapses (asset health wastewater)	Agreed as a measure of long-term asset stewardship, but has not been subject to consistency project.	
10. Possible new common measure(s) of resilience	Recommended measure is risk of hosepipe bans / security of supply index plus other bespoke measure(s).	Feasible for hosepipe bans and is also a highly tangible measure of customer experience. Sewer resilience could be measured through a flood risk measure that takes account of hydraulic inadequacy.

**Q3: What is your view on how we might apply comparative assessments at PR19?**

We note your preference for forward-looking commitment levels that are more challenging than upper quartile, with normalised rewards and penalties, with no glide paths and limited application of company-specific factors. Our view is that, whatever your approach to comparative assessments, this must be consistent with all of the other elements of your price control. Forward looking-targets that are more challenging than upper quartile will mean that at least 80% of companies incur penalties. Figure 3 of your consultation shows that this will increase the cost of capital and lead to higher bills unless this is accompanied by sufficient cost allowances in your cost assessment. For the reasons articulated elsewhere, this is also unlikely to lead to companies focusing their expenditure on the service levels that customers truly value.

It is clearly important to make comparisons on the basis of consistent definitions.

Undertaking comparative assessments as part of the risk based review would allow you to assess the extent to which companies have themselves made use of comparative information in their customer engagement. This should ensure that stakeholders are better able to challenge companies and the performance commitments are therefore more stretching.

**Q4: To what extent do you agree with our proposed approach to leakage performance commitments for PR19?**

In our answer to question 2, we make clear our view that the metric for total leakage measurement should be normalised by length of main to be meaningful to stakeholders and that three year averages are most appropriate.

We agree that data should be consistent if the measure is a normalised one. If the measure is not normalised, there is benefit in retaining a consistent data set for each company. We would recommend that you split out company and customer leakage since companies are less able to reduce leakage where it occurs on private property and this should be made clear.

We think it appropriate that you will require companies to report the sustainable economic level of leakage in their business plans and that leakage performance commitments should be related back to the SELL. Making companies spend money on something their customers do not value is not appropriate and where companies are in water surplus, they will have more important priorities than leakage (particularly as the leaked water is eventually returned to the water table). We currently spend £24 million annually abstracting, treating and distributing water to our customers. We spend £16 million annually fixing leaks. We therefore encourage you to adopt an approach that ensures that companies do not invest customers' money inefficiently to meet uneconomic targets.

Repairing customer-reported leaks within a day – one of our bespoke performance commitments – is a service that customers value, whereas reducing the total amount of water leaked may be a meaningless measure of service performance. One measure taken to reduce leakage is to reduce water pressure – which our SDS research shows is not an option favoured by our customers. The ultimate solution to fixing leaks is to replace rather than repair older pipes, with funding made available for this option. Making leakage performance a common measure and imposing stretching targets on companies is not without cost. We have reduced leakage significantly in the past but meeting ever-decreasing targets comes at a cost: every £1 million spent on leakage is passed on to customers as additional £1.67 on their bills.

**Q5: What factors should we take into account in our guidance on setting performance levels for bespoke performance commitments at PR19?**

An important element of risk-based regulation is the transfer of risk to the companies and with it the decision-making necessary to balance the improvement of service with cost while maintaining an acceptable level of risk. In the current economic climate, it is not realistic to expect our customers to fund stretch improvements in every area of performance, just as it is not realistic to assume that a company will improve its performance in every area within a single price review without either additional risk or cost.

It is therefore important that for the bespoke performance commitments companies have the latitude to assess the overall mix of their target levels across more than one AMP period in consultation with their CCG and customers to maximise the performance improvement achieved in the most efficiency way. This will inevitably result in the setting of early stretch improvements in performance levels for those performance commitments that are most important to customers.

We are in the process of updating our long-term strategic direction with our customers which is aligned with our outcomes and which will provide a focus for the relative priorities of the package of bespoke performance commitments.

In order to consult meaningfully with our customers and CCG on the specific target levels we recognise the importance of using all available evidence to support our proposals and this can include triangulation of the following factors appropriate to each individual performance commitment.

- Customer engagement techniques
- Comparative performance information
- Historical performance information
- Expectations of future improvements
- Current marginal costs and benefits

We do not believe you should be prescriptive in the guidance on how companies achieve this evidence base for the setting of bespoke performance commitments. If there is too much guidance, it will detract from the ability of companies to be innovative.

**Q6: What is your view on our development of a new customer experience measure for PR19?**

We already measure customer satisfaction as part of our existing tracker survey and we have recently undertaken analysis of our tracker surveys to identify what matters most to our customers to understand particular service issues over a longer time frame.

We agree that the SIM has been very successful in driving improvements to customer experience and service and it is a well-established comparative performance measure. Although we agree it needs to be reviewed to make sure it remains future proof, we must be careful to avoid making it too complex or subjective particularly due to the potential size of the reward or penalty involved.

A summary of our views on the new customer experience measure is that:

- It should focus on customer service as opposed to full service as this is directly within the control of the company and better facilitates external comparisons
- Satisfaction should be the key measure for both retail and wholesale and satisfaction scores should be collected via in-depth but concise surveys
- It should include comparisons with other relevant sectors by asking a question within the survey and that comparison can be used to calculate an element of the financial reward or penalty
- We support the views of bill payers being included where there has been an element of measurable customer service such as viewing an online map or receiving a supply interruption notice but this has to be done in a robust and consistent way across companies
- Likewise we support a more multi-channel approach of collecting feedback subject to this being done in a robust and consistent way
- We believe the current mix of qualitative and quantitative measures is appropriate
- We do not support the inclusion of a specific question asking the customer to disclose if they are vulnerable. A well-designed satisfaction survey should pick up whether a customer feels the appropriate level of customer care was provided
- The new comparative measure should focus on household customer service only leaving companies to undertake their own satisfaction surveys with retailers or other customers

Our detailed response to the eight individual questions is set out below:

1. We believe the new customer experience measure should focus on customer service, or the transactional element, rather than full service. It would not be appropriate to apply significant rewards and penalties to a measure of full service.

Customers often do not fully appreciate the full service offered by their water company as they only directly experience elements of it. Their views are often

influenced by external factors such as the media or extensive and costly marketing campaigns. By contrast, customer service is directly within the company's control.

A number of other performance commitments already measure the full customer experience including supply interruptions, sewer flooding, value for money and customer effort.

Limiting the measure to customer service also lends itself better to incorporating comparisons with other companies outside of the water sector.

If Ofwat consider a measure of full service is appropriate, this would need to be an independent tracking survey similar to the one undertaken by CCWater. It is interesting to note that in our own annual tracking survey of a random sample of 1,000 customers across our region, we find that less than 10% have actually contacted us and had a direct customer service experience. We would argue that these surveys become image or perception surveys and cannot be considered a robust assessment of the quality of customer or transactional service provided by the water company.

We believe that customer participation in the co-creation and co-delivery of solutions is important but we think it is best reflected and assessed in the context of business plans not as part of the customer experience measure.

Satisfaction should be the key outcome for the new measure as supported by Economic Insight's assessment of potential outcomes. It is the most well-known and direct measure of customer experience and more easily allows for comparisons with companies for other sectors. As referred to above we support other measures such as value for money, trust and customer effort but these are best included within companies own performance commitments.

We prefer more in-depth surveys to single question surveys as the customer is able to share more information about their experience and we gain more insight into the customer journey helping us to understand the drivers of satisfaction and dissatisfaction. That said the survey length should be as short as possible particularly if alternative research methods to the phone are to be used and the survey user friendly.

We use a real time feedback tool and seek feedback across all communication channels including digital ones such as text and Live Chat. We find it perfectly sensible to have more in-depth surveys but limit these to 4 or 5 short questions.

The SIM survey has traditionally been undertaken by phone, which is still by far the most popular method of communication with water companies. It would be straightforward to develop a set of questions that can be used in a telephone survey but then adapted and shortened to fit alternative channels.

We believe that using a single question on overall satisfaction at the end of an in-depth survey is still appropriate. An aggregate rating could be used but we would need to be careful to keep the questionnaire short enough.

2. We see no reason why satisfaction cannot be the measured outcome for both retail and wholesale. It is important to continue to measure the customer service offered by both the retail and wholesale parts of the business in any future customer experience measure.

This is currently done by including billing and operational contacts in the SIM. It helps us to better analyse which areas of our business are doing well or poorly and which to focus on. We do see confusion from consumers in the current SIM on whether they believe their contact is billing or operational. This is corrected using a reallocation process. We would welcome more upfront education/ framing in future surveys to make it clear to respondents which interaction is being discussed and with which company.

3. We agree that we should benchmark customer service against companies outside of the sector. Indeed, we do this already in our own feedback surveys using Net Promoter Score, Customer Effort and more recently we have carried out our own boosted UKCSI survey as part of our membership of ICS.

There are advantages in comparing companies against each other since this has been the basis of SIM and has driven improvements. However, water companies should aspire to be as good as the “best of the best” as opposed to just their peers.

We are not in favour of separate comparisons for billing and operational satisfaction (or retail and wholesale) as this would be very untidy.

Therefore the most obvious comparison would be with other sectors such as utilities, automotive, transport or telecommunications as they offer a similar type of service

In order to provide a direct and accurate comparison, we believe a question would need to be included in the satisfaction survey for the new customer experience measure asking the customer to rate the company with other sectors. The response to that question would then be used in the calculation of the financial reward or penalty.

We do not think it is appropriate to use an external survey score as the basis for comparison. The use of the UKCSI survey has been suggested. Although we find these surveys useful, the sample sizes for each company are still very small and the surveys rate interactions that happened within the last 3 months. For example, the July 2016 UKCSI score for Wessex Water was based on the views of only 59 customers. Our score in that survey was 77 but the statistical confidence around that number is quite large. The most recent survey published this month has seen our score rise to 79.5 (3<sup>rd</sup> of the utilities sector). In both surveys, we did not receive a complaint rating as the numbers of complainants were too small. In addition, the

survey is run entirely online and contains questions that are not really relevant to water companies.

By contrast we find the UKCSI surveys done by ourselves as part of our membership to be far more useful and accurate. We recently ran the UKCSI survey for the first time with our customers using telephone interviewing and a representative sample size of 300 contactors, a bigger sample than used to generate our score in the national UKCSI surveys. Our score was 87 which was considered to be distinction and would have put us at the top of the top 50 in the latest published six monthly survey along with Amazon.

We would be in favour of a cross industry benchmark forming part of the comparative performance measure. We would suggest the majority of the relative reward or penalty is based on a comparison of a water company with their peers as is done now in the SIM and then an element of the reward adjusted based on the company's performance against other sectors.

We would not be in favour of a target being applied to the customer experience measure based on the UKCSI unless the UKCSI methodology is made more robust, governance introduced and sample sizes significantly increased.

4. We believe the new customer experience measure should be a measure of customer service not full service. To that end, we are happy for the new measure to include a wider group of customers as long as they have a measurable interaction with the company.

We do not believe that customers who have simply received a bill should be included as this becomes a perception survey as discussed above. Equally we are not in favour of widening the measure to all end users as this will include customers in for example resale situations where the water company has no control over the amount the customer is billed or the quality of the water and waste water services provided.

In our case, the current SIM is not entirely limited to active and direct contact. It does for example include the views of bill payers who have completed an online form to move home or set up a direct debit i.e. self-serve because we are able to raise contacts on the back of these interactions that are provided in survey datasets. We assume that other companies operate in a similar way.

It does not however include a customer who has simply gone onto the website to view information such as a map of their area or a customer who has received a letter from their water company advising of a planned interruption to their water supply. We are not against the inclusion of such interactions within the measure but we fail to see how this can be done in a robust way, essential for a comparative measure. For example, it may require consistent survey tools inbuilt into company websites that seek real-time feedback as customers view parts of the site.

5. We offer customers a wide choice of communication channels including warm voice telephone answering, email, text, Live Chat, social media and online self-service. Digital channels are increasing in popularity but analysis of our own contacts shows that the vast majority of customers still prefer to use the telephone even for billing issues.

This is different to banking and retail where customers want to access services more frequently, for example keeping a daily eye on their bank account.

That said we do need to make sure the new customer experience measure takes account of any growth in these digital channels and it is important that companies provide a consistent customer experience across them.

With any satisfaction measure, it is important that the method of feedback matches the contact channel used. For example, if the customer has telephoned the company then the satisfaction survey should ideally be undertaken by phone.

We use a real time survey tool to gather feedback each day across all of our feedback channels but this is an investment that some of the smaller companies may not be able to make. We also monitor social media and carry out sentiment analysis.

If it is decided that the new comparative customer experience measure is to be based on feedback gathered from companies own real time feedback tools, social media analytics or surveys on companies own websites, Ofwat would need to ensure this was being done in a robust and consistent way with all of the necessary governance in place

6. We believe the new customer experience measure should retain a qualitative and quantitative element and we are comfortable with the current ratio of 75%/ 25%.

We are happy with the current mix of quantitative metrics and companies have put in place robust reporting mechanisms over time. We are not in favour of removal of the unwanted contacts element as we see this as the most straightforward substitute for telephone complaints.

7. We are very proud of our customer care and very much take the approach that anyone can become vulnerable at any time. We do have a priority services register for customers with defined and often long-term needs such as a disability. However vulnerability can be very transient, so we make sure our staff are highly trained and skilled to offer the highest levels of customer care, feel empowered and confident to resolve issues and go the extra mile when they can. That way they are able to deliver great service to all customers regardless of their situation at the time.

We do not support directly asking a customer in a survey if they consider themselves to be vulnerable or reporting their scores separately. Customers would find this

uncomfortable and often do not acknowledge their situation or are too proud to discuss it.

We believe the new customer experience measure will naturally pick up whether the company has taken account of customers' circumstances purely by the satisfaction rating. Alternatively, a question could be included in the satisfaction survey exploring whether the company has treated the customer fairly or taken account of their needs.

We would also expect companies to have their own performance commitments to measure their support for customers in vulnerable circumstances such as numbers on social tariffs or compliance with the British Standard for Inclusive Services (BS18477).

8. We would prefer the new customer experience measure to be a measure of household customer service only.

That said we believe it is important for wholesalers to seek the views of developers or retailers but this should not form part of the new customer experience measure and should not have any financial or regulatory impact on wholesalers.

## **More powerful outcome delivery incentives**

### **Q7: What is your view on the options for increasing the power of reputational and financial ODIs at PR19?**

The benefits of in-period ODIs are clear since they allow for immediate reward or penalty following an annual assessment of performance commitments. However, we understand from other companies who offered up in-period ODIs for PR14 that the task of undertaking annual reporting of performance against these ODIs was significant and the burden of proof is high. While you should be applauded for undertaking a thorough review, it may be disproportionate for you to undertake a mini-price review each year, particularly if 16 companies offer up in-period ODIs to satisfy your desire that performance commitments are more powerful.

You have indicated that you may set a variable cost of equity to incentivise more ambitious plans and promote more innovation in the provision of regulated activities. While we think this has merit and is worthy of further consideration, we think that Boards would need to be clear on what constitutes an ambitious plan. To be effective this will need to be decoupled from your assessment of plans in the risk-based review (RBR), so that a company does not need to pass all of your RBR tests to be found to have submitted an ambitious plan. This will give companies greater procedural confidence when submitting their performance commitment proposals.

Linking ODIs to revenue rather than RCV may also allow for the time frame in which performance is assessed to be more closely linked to the reward or penalty but this assumes that the performance is short-lived whereas there is an argument that significant investments are long-lived and that the return should be reflected in the RCV.

More certainty from you on the indicative RORE range will help companies in planning and modelling their ODIs, as well as giving CCGs more information on which to assess the appropriateness of company's ODIs. Similarly, early guidance on rewards and penalties would be helpful, particularly on the appropriateness (or otherwise) of stated preference WTP data. We believe there are benefits in making ODIs symmetric since this provides management with an incentive to be innovative and to take risks in pursuit of rewards.

## **Better reflecting resilience in outcomes**

### **Q8: What is your view on our proposals for better reflecting resilience within the outcomes framework?**

Resilience does not just mean reliability but it means the ability of companies to respond to unexpected events, through the development of standard business processes that allow companies to recognise and respond to change.

We support the principle of better reflecting resilience within the outcomes framework, with a measure that looks at resilience maturity (as our proposed resilience matrix will). Outcomes should focus on long-term objectives that are important to customers: our nine outcomes (PR14) were determined through the development of our Strategic Direction Statement (SDS) which looks 25 years ahead and which draws on customer engagement and a review of asset health. We are committed to long-term planning and to outcomes that span more than one price control, although we believe that performance commitments should be limited to each price control.

Establishing resilience planning principles, as detailed in Appendix 3, will further reinforce our established practice of extensive customer consultation, wide-ranging risk assessment, long-term planning and delivery of cost effective, resilient solutions.

Business plans developed upon common resilience principles will reflect the specific requirements of each aspect of service provision, fully taking into account the consumer, environmental and demographic pressures likely to be placed upon them in the future and will facilitate development of common resilience measures across the sector.

Resilient systems require sufficient headroom to cater for unexpected events. Water supply sector resilience measures should directly reflect the level of service experienced by customers – our objective in delivering drinking water services is to deliver the highest potable water standards to customers, in sufficient quantity and pressure to meet their demands, irrespective of season, environmental or sociological pressures. Resilience of the supply service correlates well with the current SoSI measure, although we are proposing to use additional measures such as frequency of hosepipe bans or other user restrictions as a comparative measure of supply resilience.

UKWIR is undertaking a project on resilience that is due to report back by this Easter, which is intended to help companies identify suitable metrics by which to measure resilience. Our Water Resource Management Plan aims to deliver a level of service that will be constant even in a very dry summer but we also use additional resilience options to deal with exceptional dry weather. We offer our customers the option of moving to meters to improve their water efficiency and mandate meters on change of occupancy (where this is viable).

Resilience measures should not just be confined to customer experience measures. Our impact and influence on the environment from which we draw and return treated water is also important: for water supply, environmental resilience is already addressed by the

Abstraction Incentive Mechanism and leakage targets and for wastewater services, environmental resilience is well served by present pollution measures.

Educating customers about water efficiency – a demand-side measure – can help create headroom in the system (a supply-side benefit) and increase resilience. Measuring PCC normalised by population changes over the course of the AMP may therefore provide a measure of water supply system resilience.

The 21<sup>st</sup> Century Drainage project has a workstream that is looking at the issue of sewer resilience. The flood risk grid is our existing measure of hydraulic capacity and therefore our resilience to extreme weather and this is one of our existing performance commitments.

Wastewater sector resilience measures should also directly reflect the level of service experienced by customers, in terms of system capacity. Research undertaken for us by Decision Technology makes clear that customer satisfaction may improve where companies respond quickly and efficiently to a service failure – but that only one service failure is acceptable. Where customers have experienced service failures, we take steps, where we are able, to improve the resilience of our network to ensure that a second service failure is significantly less likely. For example, on internal sewage flooding, we always use a camera post-blockage to check the structure and we can choose between removing an interceptor trap or installing non-return valves to reduce the likelihood of failure. This might suggest that resilience measures should focus on repeat failure, since this is what matters most to customers.

**Q9: What is your view on the options and our preferred approach to asset health outcomes?**

We consider that the most appropriate asset health measures to measure are the ones that relate to the network i.e. mains bursts and sewer collapses, because the performance of above ground assets can be satisfactorily monitored through the common service performance measures. At PR14 we included mains bursts and sewer collapses as performance commitments related to our resilience outcome.

We agree that, at the most fundamental level, assets are a means of providing services and that as customer service is monitored through the customer experience measure and service measures, monitoring of asset health could be deemed to be unnecessary. Nevertheless we agree that the most important asset health measures should be measured to provide confidence about the long term stewardship of these assets by companies.

Our comments on the draft proposals and options regarding asset health are as follows:

a) Draft asset health outcomes expectations

We support the six expectation guidelines include in Box 3.

In relation to the fifth guideline, and as mentioned in our response to question 2, the two principal asset health indicators of mains bursts and sewer collapses have not been subject to a review of the consistency of definition and its application.

b) Draft asset health performance commitment reporting requirements

The old serviceability assessment included a lead indicator for each sub service and then sub measures. There were four lead indicators and a further 16 sub-measures.

As mentioned above we consider that asset health measures are only relevant for infrastructure assets. The infrastructure sub-measures are all covered by other service metrics. For example sewerage infrastructure serviceability included a sub-measure for pollution incidents which is already one the proposed common measures.

Further examples for the water service include:

- Supply interruptions are not a good indicator of asset health as primarily it is a measure of operational response to asset failure and not indicative of long term asset deterioration
- Network water quality issues will be accounted for by the compliance performance commitment, with the onus is on companies to manage the network water quality risks

- Customer contacts about the appearance and/or taste and odour of water should similarly be covered by the new SIM replacement and DWI event regulation.

Therefore whilst we have no objection to the reporting requirements in Box 4, we do not consider that the focus on sub-measures is beneficial.

c) Standardisation on asset health performance commitments

We do not support a fully standardised approach (option 2). This would be a return to the previous serviceability assessment approach with unnecessary overlap with other measures.

It is important that companies are still given the freedom to innovate and maximise the performance and life of existing assets. For example at PR14 we advocated the introduction of more real monitoring within the network as a means of providing improved customer service whilst deferring the increase in mains replacement that would be required if the sole target was a reduction in mains bursts numbers.

d) Rewards for asset health ODIs

We agree that asset health is about maintaining stability rather than large improvements. It should be recognised that the network asset base is ageing and therefore even maintaining stable asset health metrics involves considerable investment just to hold the current position within limits.

## **Making performance commitments more transparent**

### **Q10: To what extent do you agree with our proposals for making performance commitments more transparent for customers?**

Clarity on your requirements for when companies should submit definitions on performance commitments would help enable us to engage with customers to ensure that they meet your principles of transparency. Making bespoke performance commitments clear, unambiguous, complete and concise may be a lengthy task, particularly with complex environmental performance commitments.

Your proposals are intended to make customers more aware and CCGs better able to challenge companies' business plans. Transparency is an important objective and companies should be able to take on board your recommendations without difficulty, albeit at an additional cost.

In our view, the requirement for simplicity of performance commitments and common targets changes in the event that the government progresses with household retail competition. Where relationships form between wholesalers and retailers, these will necessarily be contractual in nature and a level of complexity when sharing risk between the parties is to be expected.