

By email to: [water2020@Ofwat.gis.gov.uk](mailto:water2020@Ofwat.gis.gov.uk)

PR19 draft methodology

Water 2020

Ofwat

Centre City Tower

7 Hill Street

Birmingham

B5 4UA

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Dear Water 2020 Team,

We welcome this opportunity to respond to the consultation for the draft methodology for the 2019 price review (PR). This is an important milestone for the industry as the first entire price review period following the opening of the non-household water retail market.

The draft methodology for PR19 has set an ambitious vision for the future of the water industry. We broadly support the proposals made in the consultation relating to the non-household retail market. We make several observations in our attached detailed response that we believe are worth considering in relation to the price review process and its interdependencies with the non-household (NHH) market. In particular, we urge Ofwat to:

- Clarify the role of retailers in PR19 in terms of customer engagement and the assessment of business plans
- Seek greater alignment between customer and developer services experience incentives, WaterworCX, and the Market Performance Framework (MPF)
- Consider the interdependencies between developer services and D-mex
- Ensure there is an integrated and holistic strategy for the recently opened NHH market and upstream markets to ensure they function in a complimentary manner to realise the intended benefits for customers.

We are happy to discuss any of the points raised in this response in more detail and look forward to the development of the methodology and the next steps of the price review.

Kind regards



Chris Scoggins

Chief Executive Officer

MOSL

Market Operator Services Limited

Registered in England & Wales No: 09276929

Registered Office: One Wood Street, London

EC2V 7WS

## MOSL's response to Ofwat's consultation Delivering Water 2020: Consulting on our methodology for the 2019 price review

### Introduction

Market Operator Services Limited (MOSL) is the market operator for the non-household (NHH) retail water market. We are responsible for providing the governance, infrastructure and information to enable customers to switch retailer and for settlement to take place between wholesalers and retailers. As the market operator, MOSL's remit is to enable the market to operate effectively and efficiently, providing a 'level playing field' for all companies operating in the market.

We welcome this opportunity to comment on the draft methodology for the 2019 price review consultation. The next price review period will play an important role in the functioning of the NHH market, driving wholesale performance, challenging wholesale charges and ensuring that water companies deliver the services that customers want.

We broadly support the pro-market principle of the methodology and the focus on customer engagement. We would like to offer a few comments on areas of the methodology which we believe could benefit from further clarification or consideration. These include:

- Clarify the role of retailers in PR19 in terms of customer engagement and the assessment of business plans
- Seek greater alignment between customer and developer services experience incentives, WaterworX, and the Market Performance Framework (MPF)
- Consider the interdependencies between developer services and D-mex
- Ensure there is an integrated and holistic strategy for the recently opened NHH market and upstream markets to ensure they function in a complimentary manner to realise the intended benefits for customers.

### Clarifying the role of retailers in PR19

#### Customer Engagement

We welcome the focus on customer engagement as part of the development of business plans required by the PR19 methodology and Ofwat's expectations for companies to continue engagement with NHH customers.

We note that Ofwat has stated its expectation for wholesalers to also engage retailers as part of the customer engagement process. We support the principle of wholesalers engaging retailers, but believe that this should be strengthened and made a more explicit expectation. The methodology currently groups retailers as 'other stakeholders', but there is a strong case to expand the role of retailers in relation to customer engagement. As of April 2017, retailers are now the customers of wholesalers and we believe that the methodology should classify them as such.

Customer Challenge Groups (CCG) play a role of challenge to companies and provide independent assurance to Ofwat on the quality of engagement and the degree to which the engagement is reflected in the business plan. Retailers could play a similar and supplementary role to CCGs for water companies, providing a useful perspective both as a customer of wholesalers and a representative of NHH customers. Retailers could provide feedback to Ofwat on the level of engagement they received from different water companies. Additionally, retailers could also provide insight as to how their NHH customers were engaged and offer an independent perspective as to how the engagement with retailers and customers has been reflected in the development of business plans.

**We recommend including retailers as a named stakeholder with a role in the methodology in table 2.2 and the expectation for wholesalers to engage with retailers made explicit. We believe that high quality business plans will include engage with retailers, but clarifying retailers role in the process will ensure this happens across the industry and help facilitate a more robust process.**

#### **Assessment of business plans**

CC Water and CCGs provide independent assurance to Ofwat and challenge to water companies during the initial assessment of business plans and the assessment of the revised business plans.

Principle 5 of customer engagement is that customers and their representatives must be able to challenge the companies throughout the process. The engagement process should ensure this challenge happens. If this is not done effectively, Ofwat must be able to challenge on the customer's behalf. In doing so, Ofwat will be fulfilling its duty to protect customers.

Retailers are customers of water companies and representatives of NHH customers. Many retailers will have the relevant expertise to challenge business plans and provide assurances to Ofwat on behalf of customers and themselves. They can ensure that Ofwat are challenging the areas of the business plans that matter most to customers and provide the assurances to Ofwat that wholesalers business plans are reflective of customers.

**We recommend including a specified mechanism in the methodology which engages retailers in the process of initial assessment and final determinations. We believe that there is an opportunity for Ofwat to utilise the new unique position of retailers as part of the PR19 process to provide assurance to Ofwat and challenge to the business plans.**

#### **Alignment between customer and developer services experience incentives, WaterworCX, and the Market Performance Framework**

One of the key arguments for introducing competition into the NHH retail sector was that it would drive improvement in the service provided to NHH customers. Customers who are not offered the levels of service that they expect can switch retailers.

Wholesale service performance in the market is incentivised by Wholesale Contract, Code Subsidiary Document No. 0002: The Market Performance Framework (MPF). The aim of the MPF is to provide confidence to trading parties and MOSL that they and other trading parties are complying with the obligations set out in the market codes. It is also to provide confidence that any risks to the central systems are being managed and that the performance of the market is being continually improved. The MPF is made up of the Market Performance Standards (MPS), the Operational Performance Standards (OPS), peer comparison and trading party performance resolution.

The MPS covers approximately half of the Key Performance Indicators (KPI) associated with data transactions in the central system, which in turn consist of a mixture of financial and reputational incentives. MOSL invoices trading parties in the event of a failure to meet a MPS, which is a failure to comply with a KPI, and publish monthly peer comparison reports. The financial penalties are due to come into effect 12 months following go-live (April 2018), although there will be an initial review of the standards which may recommend delaying or altering the charges.

The OPS, which are reported monthly by wholesalers, monitors wholesaler compliance with a subset of KPIs in relation to bi-lateral processes pursuant to the Operational Terms, set out in the market

codes. OPS are subject to reputational incentives through peer comparison reports published by MOSL and are not subject to financial incentives.

PR19 replaces the Service Incentive Mechanism (SIM) with WaterworCX which is comprised of two new common performance commitments to incentivise a better experience for residential customers and developer services customers. In section 4.5.5 of the consultation, Ofwat notes that they are not proposing to cover retailer satisfaction with wholesale services through WaterworCX. The reasoning given for this is that there is a legal framework in place and at this early stage in the market it is not clear what, if any, service incentive mechanism would best fit the need of retailers.

We believe that there is an incentive gap for incumbent companies between the market arrangements and the proposed methodology for PR19. There is currently no incentive mechanism for wholesalers to provide greater levels of service to retailers in the market beyond ensuring they are compliant with the MPS. The MPF only provides incentives for compliance with KPIs and does not reward performance. Moreover, the MPF only provides financial incentives for KPIs in relation to transactions with the central system. There is a risk that this gap may promote perverse incentives to provide greater levels of service to domestic customers over retailers and NHH customers.

We recognise that at this early stage of the market it may not be clear what mechanism would best meet the need of retailers and reward wholesale service provision or whether this would be best suited under the market codes or the PR19 methodology.

**We recommend that there should be a plan to consider incentives for wholesaler service to NHH retailers. This plan should aim to review whether this incentive mechanism is best addressed under the market governance or the price review. We recommend a greater collaborative effort between Ofwat and the industry to ensure a balanced incentive framework that delivers for residential and non-household customers equally.**

#### [Interdependencies between developer services and D-mex](#)

We support the proposal to set up a D-Mex Task and Finish Group of developer service customers and water companies. It is worth reiterating that developer services, offered by retailers, are currently suspended from the codes and are due to come into effect in October 2018.

MOSL will be supporting the code Panel in its review of developer services over the next year and recognises that any overlap and/or gaps between the D-mex and the roles and responsibilities set out in the codes will need to be considered.

**We recommend that the D-Mex Task and Finish Group should work in collaboration with the market governance arrangements to ensure that the arrangements are fully aligned.**

#### [Integration of upstream competition with the NHH market](#)

We note that Ofwat welcomes views in the context of future market development, in particular the bi-lateral market, which is not expected to open until later in the 2020-2025 period. The bi-lateral market would potentially allow retailers to procure water resources directly from third parties to seek efficient ways to meet customer needs and demand.

A bi-lateral market may have implications on access pricing and settlement in the NHH market. An upstream entrant with the appropriate 'authorisation' providing water to a retailer may affect wholesale revenues and potentially introduce volume risk.

One of the key principles of the Market Arrangements Code and the Wholesale Contract, which govern the NHH market, is to not be a barrier to upstream competition. The interdependencies of

the NHH market and upstream competition require a collaborative and holistic approach to ensure that the interaction between different markets does not limit or prevent the realisation of intended benefits, especially benefits to customers.

We note that Ofwat will be publish an upstream wholesale market architecture discussion paper which will consider some of the issues in relation to access pricing and in period water resource yield adjustments. We support the proposed collaborative and consultative approach to the development of upstream markets.

**We recommend using NHH market industry forums as a means to communicate with wholesalers and retailers and get meaningful feedback on the introduction of upstream competition. We also recommend an integrated and holistic strategy for markets to ensure that they are functioning in a complimentary manner and not limiting or preventing the benefits realised by customers.**

