

PR19 and business water retailers

10 August 2017

ofwat

I want...

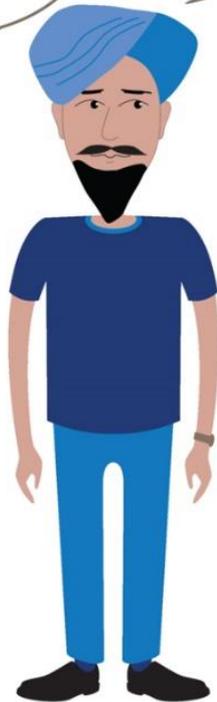
...an app
for that



...lower bills,
affordable
for all



...help 24/7

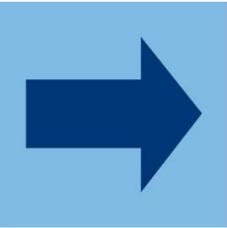


...better
customer
service



...a cleaner
environment





Aim

To explain what is PR19?

Why is it important to retailers?

Structure

What is PR19 and how is it important to retailers

How do we set price controls

Our regulatory approach to PR19 and our PR19 methodology

Our approach to the water resources market

How can retailers get involved in PR19?

Timeline



PR19 is the 2019 price review

PR19 sets the price, service and incentive package for appointees (monopoly water and wastewater companies) for the period beyond 2020

Covers wholesale and retail services

Covers residential and Welsh business retail (and English business retail if not exited)

Does not cover separate retailers

Important determinant of the wholesale price paid by retailers

How we set price controls (1)



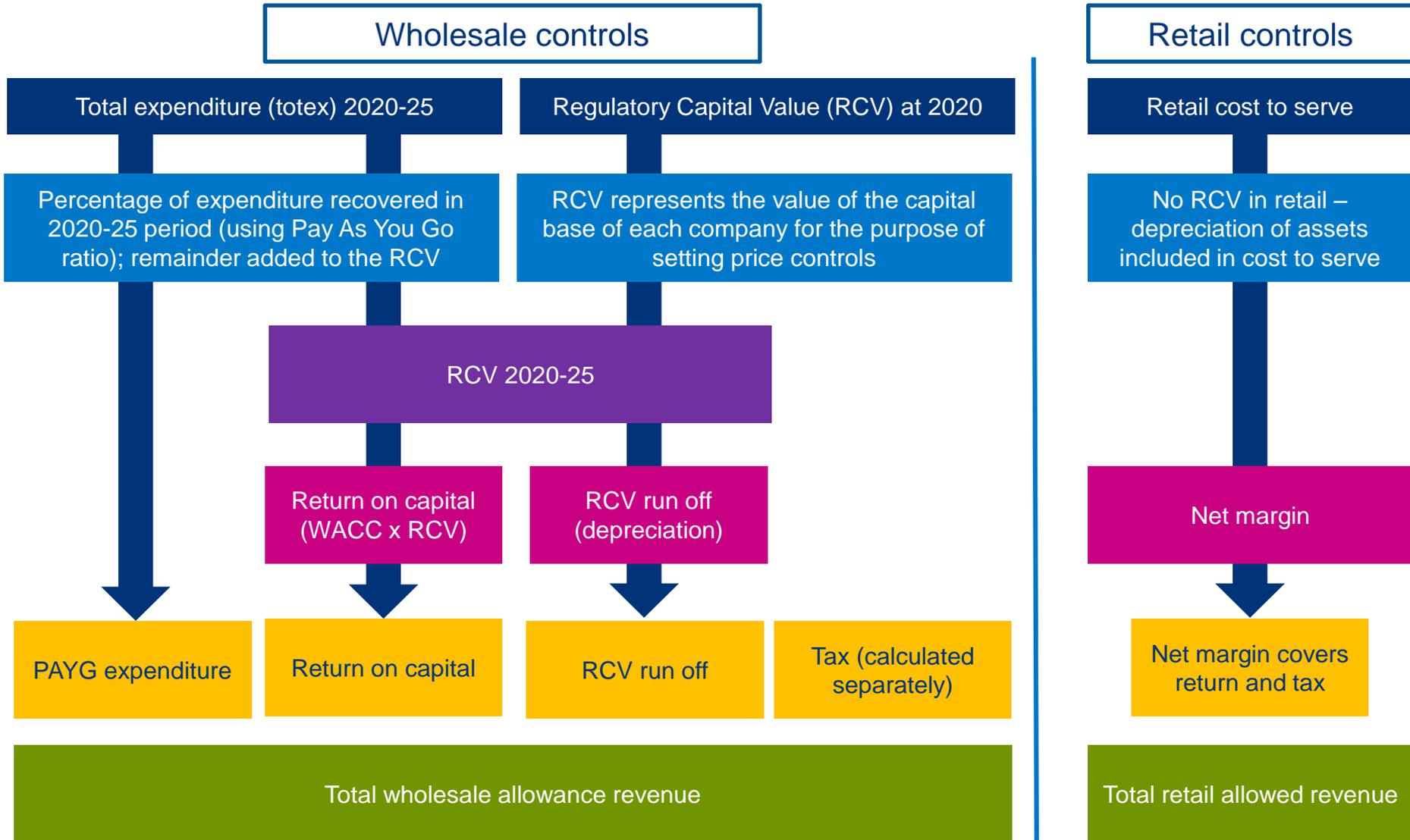
Water resources	Water network plus	Retail	Wastewater network plus	Bioresources
Total revenue control	Total revenue control	Average revenue control	Total revenue control	Average revenue control

In PR19 we will set six separate price controls

We set caps on overall or average revenue

Companies translate these into charges based on charging rules

How we set price controls (2)

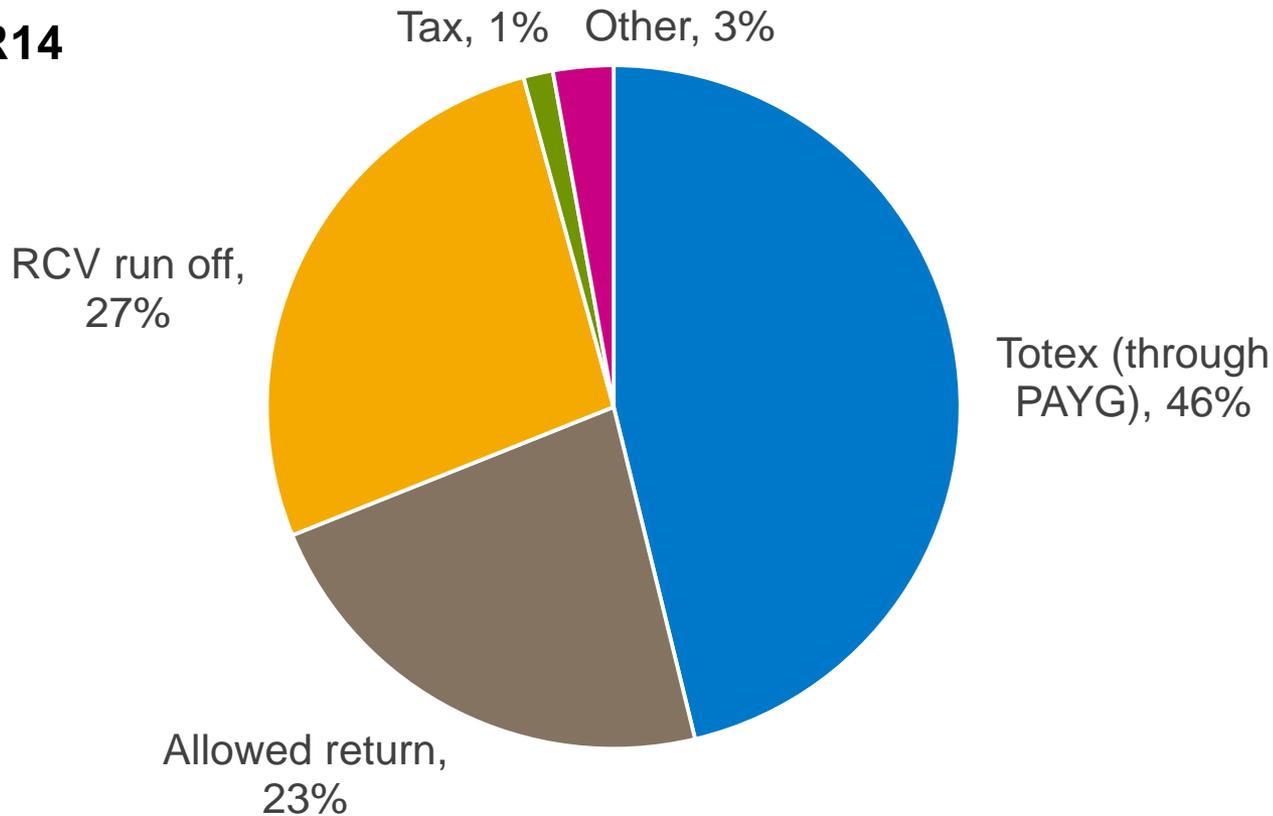


For bioresources, we will set the control on the average revenue per unit rather than the total allowed revenue

Our PR19 methodology impacts on:

- **Quality of service:** outcome performance commitments will specify the quality of service customers receive such as supply interruptions
- **Bills in 2020-25:** through Pay As You Go (PAYG) expenditure, return on capital, RCV run off and tax
- **Bills beyond 2025:** through additions to the RCV and RCV run off rate (and subsequent run off and returns)

Split of PR14 wholesale revenue



Our PR19 methodology reflects our regulatory approach and Water 2020 framework



Moving away from a model that was predominantly:

Towards a model that is more:

Through:

Prescriptive



Framework-based

Variable assurance

Interventionist



Targeted

A risk-based approach informed by market intelligence

One-size-fits-all



Proportionate

Two-way, proactive stakeholder engagement

Regulator-focused



Customer-focused

Strong working relationships with stakeholders

Administrative



Pro-market

Transparency

PR19 methodology

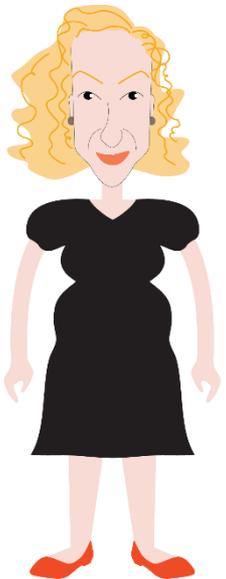
Sets our approach to PR19 and our expectations and requirements for company business plans

Initial assessment of business plans

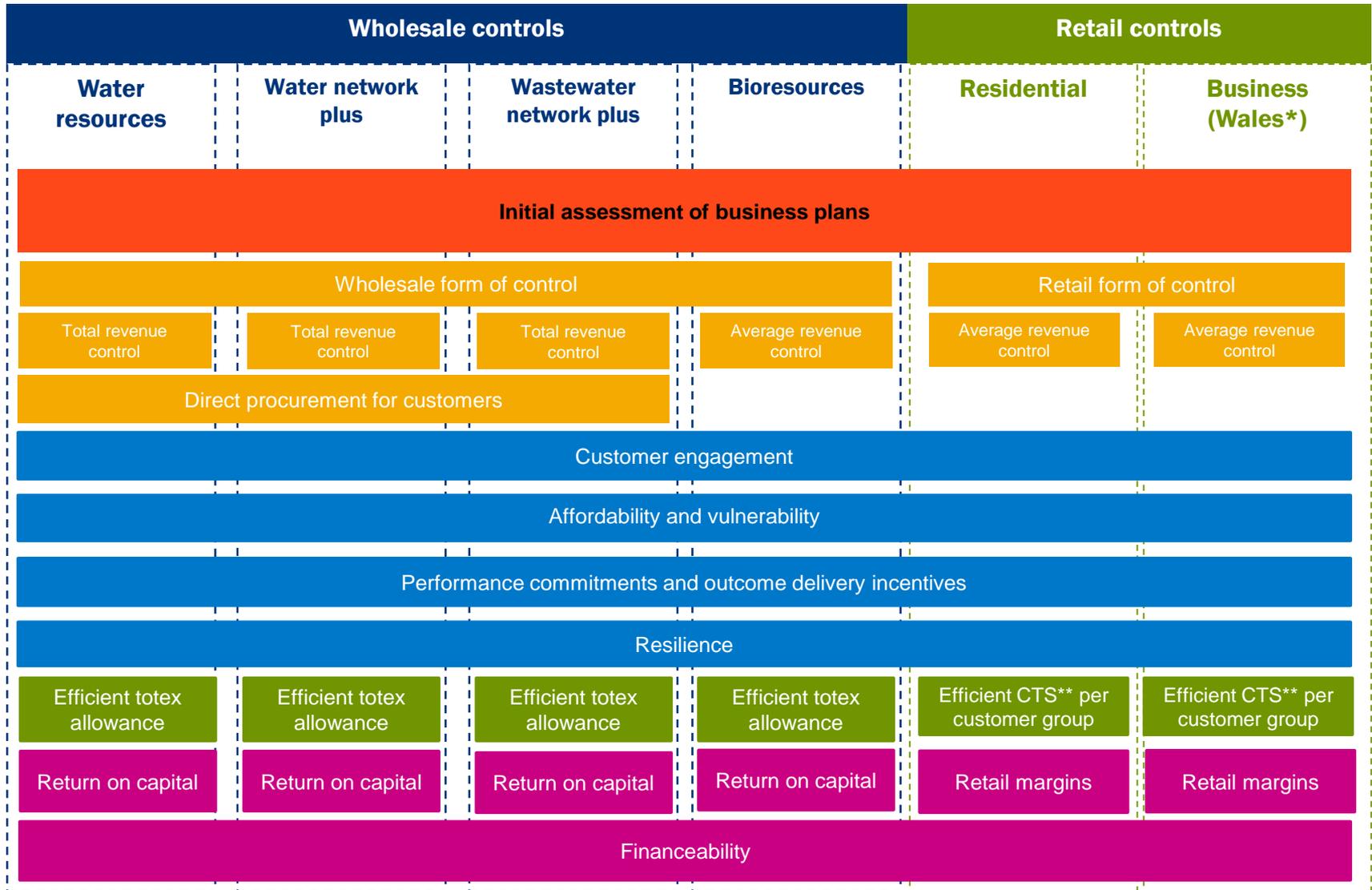
Tests company business plans against our expectations and requirements

Draft and final determinations

Price, service and incentive package for each company. Based on company business plans, with our interventions to protect customers



Structure of our PR19 draft methodology



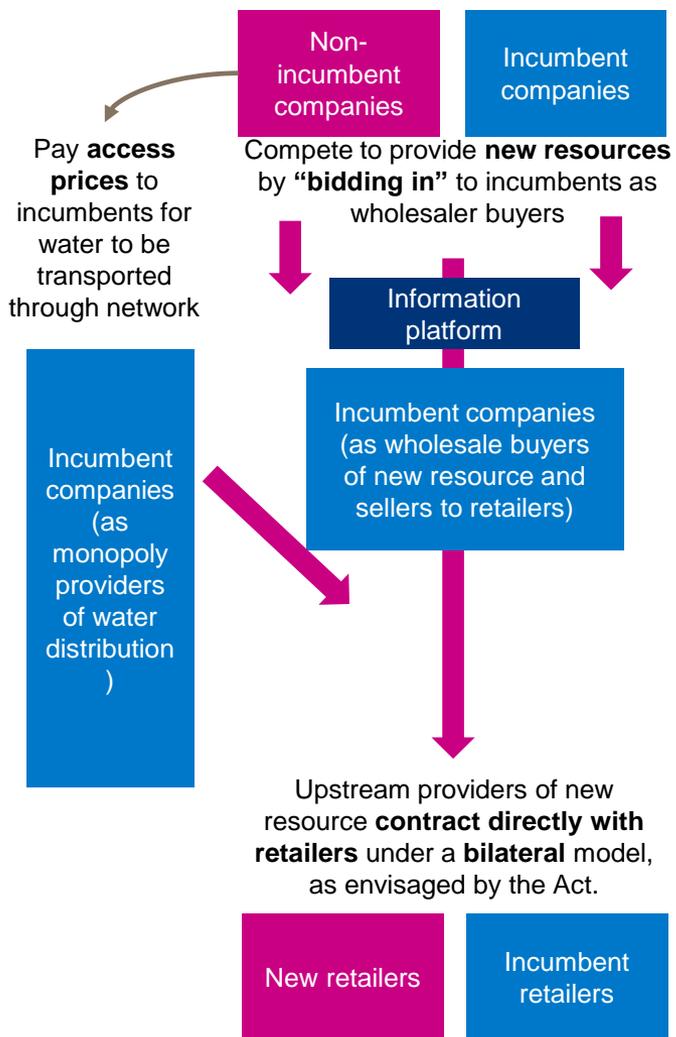
* We will continue to consider setting price controls for business retail activities of incumbent companies in England and Wales that are subject to competition

** Cost-to-serve

- We will **continue to set residential retail and business retail controls in Wales** (<50ML/year), using a similar approach to PR14 (effectively an average revenue control).
- We propose to set price controls for **three years** so that we can take into account learnings from the business retail market.

- As part of PR19 we also need to **set controls for non exited business retail** activities as customers of these companies will not be protected by the retail exit code.
- We recently reviewed these controls in the 2016 business retail price review.
- Therefore in the absence of information on the operation of the market, we would use the same approach we used in PR16
- Consistent with residential retail controls, we would set price controls for three years.

Bidding Market and Bilateral Market



Market and regulatory mechanisms

Decisions with further detail consulted on

Market information

Market information to help identify potential opportunities for water trading and put forward "bids" to other companies.

Bid assessment framework

Bids to be assessed using a bid assessment framework based on the principles of transparent, equal treatment, non-discriminatory and proportional.

Binding price control on incumbents

Separate price controls for water resources and water network plus to allow costs to be separately identified and more targeted regulatory incentives

Developing

Access pricing

Incumbents could engage in pricing behaviour to limit entry. It is therefore important to develop an effective access pricing framework.

Market architecture

September discussion document on further aspects of the market architecture that need development – including market platforms (links to market information), access pricing and form of contract. Highlights other Water Act 2014 provisions that may need to be given effect.

Follow up workshops during the consultation period to get different points of view – including from retailers

Can help to identify outcomes customers want from wholesalers

Can help to identify improvements to wholesalers efficiency and new ways of doing things

Can help to identify what else you need from wholesalers in their business plans

2017	
11 July	PR19 draft methodology consultation published
July-August	Continued engagement through consultation period
30 August	PR19 draft methodology consultation closes
Mid December	Final PR19 methodology published
2018	
3 September	Companies submit business plans to Ofwat
2019	
January	Initial assessment of business plans published
March/April	Draft determinations (exceptional and fast track plans)
April	Companies submit revisions to business plans (significant scrutiny and slow track)
July	Draft determinations (Slow track and significant scrutiny)
December	Final determinations published

Any questions?

Market overview & Data challenges

August 2017

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Timings	Item	Presenter
11:00 – 11:10	Introduction and welcome <ul style="list-style-type: none">• Overview of the market and objectives for the session	Priya Sinha
11.10 – 11.25	Retailers annual data return Specific data challenges for discussion <ul style="list-style-type: none">• Price and tariff data• Customer segmentation	Stephen Beddoes
11.25 – 12.05	Break out discussion	
12.05 – 12.15	Feedback	
12.15 – 12.20	Summary, next steps & close	Priya Sinha

Overview and objectives



Photo © Sebastian Fiebak



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Context

- Ofwat has an overarching statutory duty to ensure the market delivers good outcomes for consumers and protects consumers from harm
- One of the ways, we seek to achieve our duty is to monitor the market effectively e.g. consider how well is competition working, assess the outcomes for consumers (including particular customer groups)
- There will be keen interest across a range of stakeholders on this – of vital importance to a number of stakeholders including government, consumer groups, other regulators, market participants
- The success of the market will reflect on all of us. It is in all our interests to make sure that the market works effectively for consumers.

Objectives

- The objective of the workshop today is to explore issues around some of the more challenging aspects of the retailer data request to ensure we can secure reliable and good quality data to inform our assessment
- We want to work collaboratively with you and to give you an opportunity to contribute to our thinking in this area

Retailer's annual data return



Our monitoring framework allows us to understand whether the market is operating in the best interest of customers, and if not, the best way to act to prevent customer detriment. The framework helps us to:

- identify and assess barriers to effective competition;
- track the evolution and nature of competition in the market;
- assess the impact of existing regulation;
- consider regulatory interventions that could improve the effectiveness of competition; and
- intervene in an appropriate manner to protect customers' interests.

Our monitoring work will feed into our annual state of the market report we are expecting to publish in 2018. This will set out how effectively competition is delivering for consumers in the early stages of the market.

We need information from market participants to carry out our functions. Wherever possible, we have tried to get data from the market operator, but there are aspects of the market that it does not have sight of.

Condition 8 (1) of the water supply and sewerage licence requires licensees to provide Ofwat with information.

We are going to ask for information on:

- Number of SPIDs supplied and number of customers supplied
 - Renegotiated contracts
 - Number on statutory schemes of terms and conditions
 - Transactions involving a third party intermediary (customer)
 - Transactions involving a third party intermediary (retailer)
 - Accounts receiving a multi-utility bill
 - Accounts in debt
-
- Price/tariff data
 - Data to be segmented by customer type – e.g. microbusinesses, multi-site business

Why do we need data on prices and tariffs?



One of the key benefits of market opening for customers is expected to be some combination of lower prices and better service.

It is important for us to be able to understand the direction and nature of tariffs charged to customers in order to be able to assess whether the market as a whole is achieving the outcomes we (and customers) want.

The issue

Retailers are evolving their tariff structures as the market develops. We are seeing use of different tariffs and prices structures:

- a straight discount from a customers existing bill / default tariff
- adding a retail margin on top of each wholesale tariff
- Individually negotiating tariffs with customers, especially larger users.

The challenge therefore is to identify an information requirement that is both proportionate on retailers, as well as providing us with the detail we need to understand what is happening in the market.

Propose a two stage approach – we need more information before we can finalise the nature of the final data request on prices and tariffs.

1. August data request to focus on:

- Qualitative description of how retailers are structuring tariffs and calculating prices
- Types of tariffs and who they apply to
- Number of standard services offered and associated tariffs
- Range of tariffs, number of customers in each range
- Percentage of negotiated charges compared to standard charges
- Average saving per customer (compared to previous years bill or default tariffs)

All the above to be segmented by customer size where applicable

2. Data request planned for November (retailers submission expected in February)

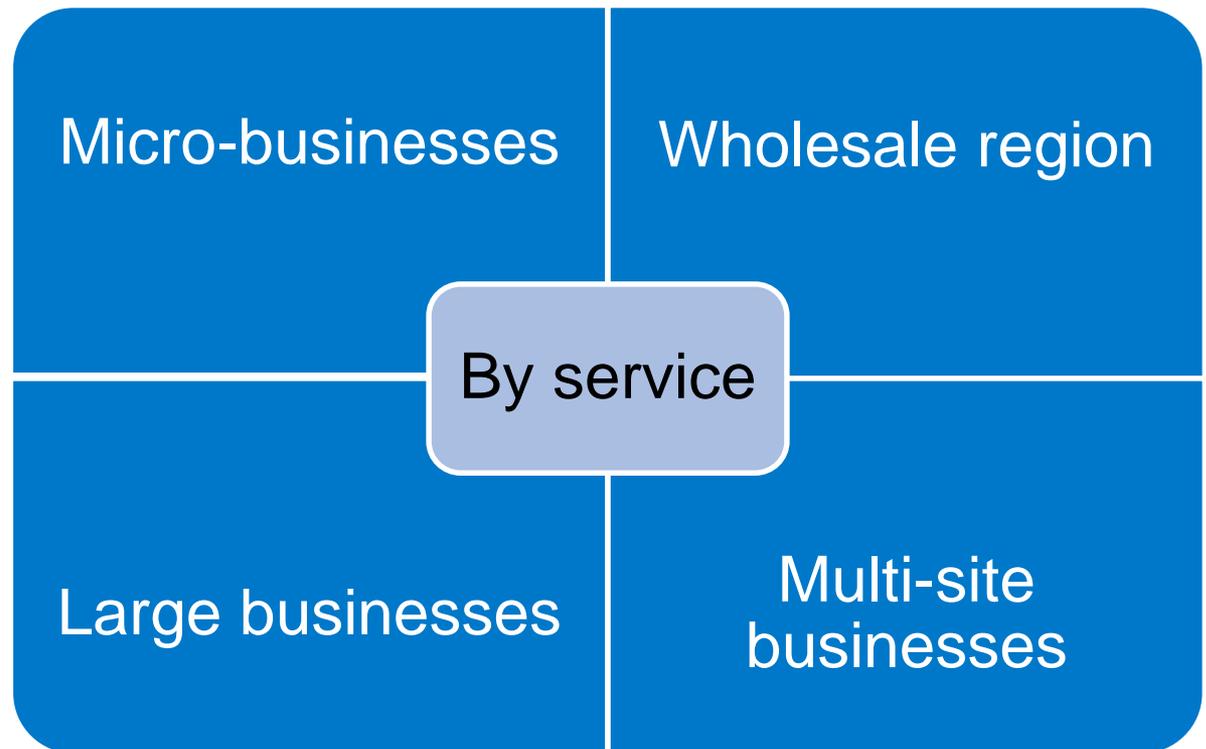
Plenary discussion

Why do we need this?

In order to fulfil our duty to protect consumers we need to understand how the market is working for different groups of customers.

We know from other sectors that smaller non-household customers, particularly microbusinesses, may require additional protections.

This allows us to ensure regulations are appropriately and proportionally targeted – or removed if proving unnecessary.



What is the issue?

Over time, as retailers begin to engage with their customers, we would expect retailers to develop a fuller picture of their customer base. We know some retailers have acquired large numbers of customers whilst inheriting little or no information on the characteristics of those customers.

However, in the interim, we need to ensure that we get sufficiently robust data to ensure that the market is working effectively for customers. This could involve a proactive approach whereby retailers contact all their customers directly.

An alternative suggestion was that retailers exclude all SPIDs where they are known to relate to large businesses and reactively record microbusinesses at the point of switching / starting a new contract.

But there are risks (discussed on next slide) that this alone will not deliver reliable, good quality, comparable data that identifies the group of consumers that we need to monitor and ensure are appropriately protected.

We want to work together to find a consistent methodology for identifying and monitoring customer segments.

Risks with reactive recording:

Data likely to overestimate microbusinesses since the approach is likely to result in small and medium sized businesses being included within the microbusiness (less than 10 employees) categories

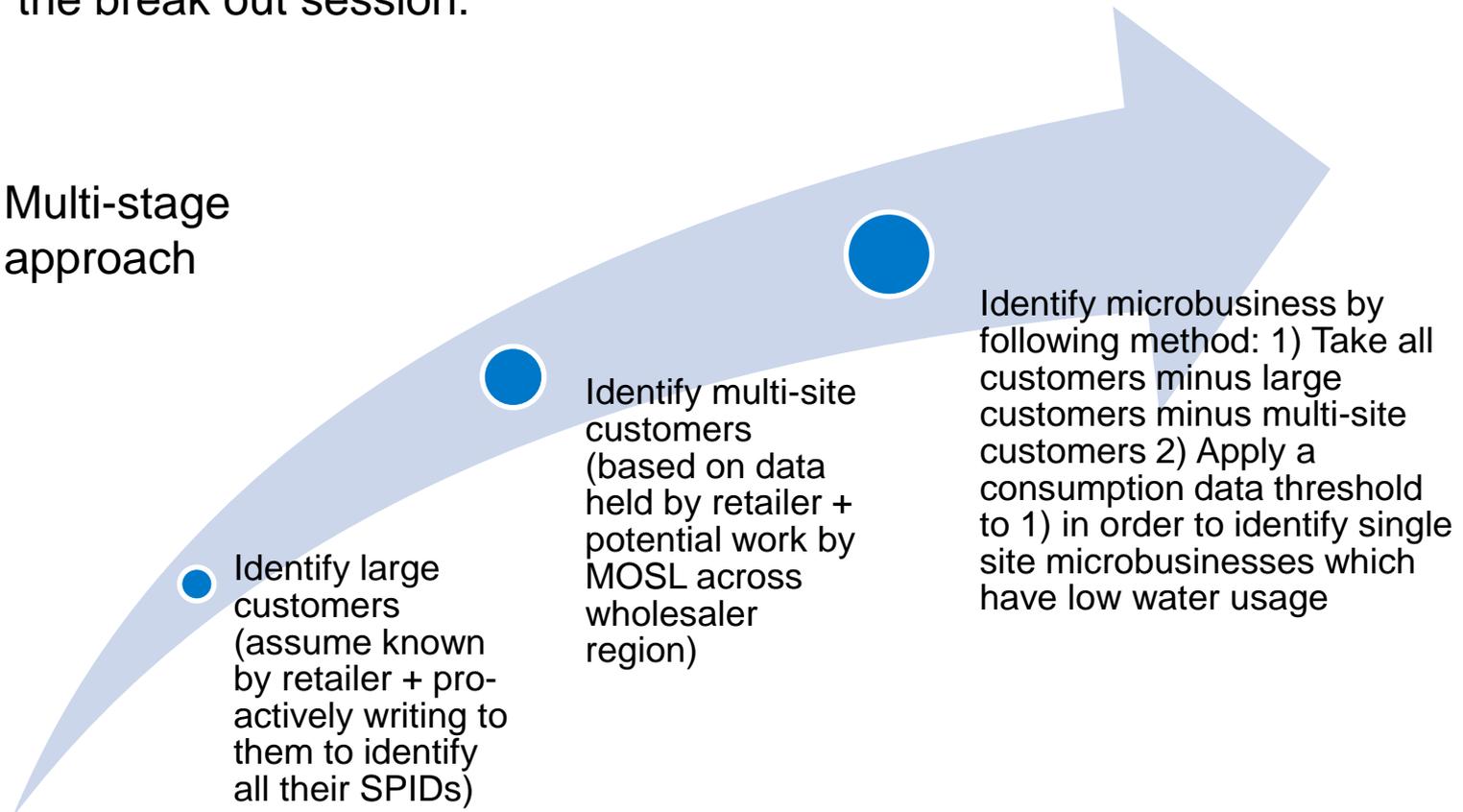
Data might lead to larger businesses being counted multiple times since difficult for retailers to identify larger multi-sited businesses which operate in different wholesale regions

Relying on reactive approach (i.e. switches and new contracts) to identify size of businesses is unlikely to deliver good quality, comparable data across retailers in reasonable timeframe, given current switching rates

To get good quality interim data, we are likely to need a number of different stages. One suggestion is provided below.

We are looking for feedback on this and open to receiving alternative ideas as part of the break out session.

Multi-stage approach



Break out discussion & feedback



In your groups we would like you to discuss the following :

- Whether multi stage approach could be effective at providing reliable data in timely way. Identify any improvements that could be made. Identify mitigations to any risks raised.
- Consider whether there are any other approaches which you believe could achieve our objectives of delivering robust, reliable data in a timely way. Explain the option(s) fully setting out the benefits and the risks.
- Consider how best to leverage existing CMOS data.
- Identify short term vs long term solutions.

Summary and next steps

2017	
August	Ofwat sends Price/ tariff request to retailers
November	Ofwat sends formal annual data request to retailers
2018	
February	Retailers submit data returns to Ofwat
Spring/ Summer	Ofwat publishes state of the market report