

August 2019

Trust in water

Reconciling the business retail service incentive mechanism consultation

About this document

Business retail customers of companies operating wholly or mainly in Wales that consume less than 50MI of water a year, and all wastewater customers of these companies, are not able to choose their water and/or wastewater retailer. In the absence of market discipline, we wanted to ensure that these companies had a strong incentive to provide a high-quality retail service to these customers through the 2015-20 period. We therefore set the business retail service incentive mechanism (the 'business retail SIM') as a financial outcome delivery incentive for Dŵr Cymru Welsh Water ('Dŵr Cymru') and Dee Valley Water Limited ('Dee Valley Water') in the 2014 price review (PR14). The business retail SIM provides a financial incentive to provide a high-quality retail service as measured through complaints performance.

This document sets out our proposed approach to reconciling the business retail SIM so that business customers bills reflect the service that they have received. We set out our proposals for how we will use the performance data for 2015-16 to 2018-19 to set the performance payments due to the relevant companies under the business retail SIM.

We are carrying out this reconciliation for Dŵr Cymru and Hafren Dyfrdwy, as successor to Dee Valley Water, as explained in section 1 below. As Severn Trent Water Limited ('Severn Trent Water') has exited the business retail market, it is not eligible to receive any of Dee Valley Water's business retail SIM incentive payment, as explained in section 2.4 below.

We will use the business retail SIM scores to make revenue adjustments in these companies' 2019 price review (PR19) final determinations. Responses to this consultation will be taken into account when setting the PR19 final determinations.

This consultation is being conducted in accordance with our statutory duties and the Welsh Government's statement of strategic priorities and objectives for Ofwat. We have also had regard to the principles of best regulatory practice, including the principles under which regulatory activities should be transparent, accountable, proportionate, consistent and targeted.

For all other documents related to the PR19 price review, please see the [draft determinations web page](#).

How to respond

Responses to this consultation should be provided to us by **10 am on 4 September 2019**. Responses can be made by all stakeholders. Responses can be sent either to our PR19 inbox (PR19@Ofwat.gov.uk) or by post to our Birmingham office address: Ofwat, Centre City Tower, 7 Hill Street, Birmingham, B5 4UA.

To ensure transparency, we expect companies to publish their responses in full. We also intend to publish all the written responses we receive on our website.

In view of this, if respondents consider that some of the information in their responses should not be disclosed (for example, because they consider it is commercially sensitive information) they should identify that information and explain why. We would expect strong, robust reasons that are specific to the information concerned. We will take such explanations into account, but we cannot give an assurance that information included in responses will not be disclosed.

Where companies are making responses, they should consider what further evidence may be necessary to submit with their responses as a result of this consultation. Where companies consider that we have not appropriately considered any points previously raised by the company, companies should include this within their responses.

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1. Background

The service incentive mechanism (SIM) is a regulatory incentive mechanism that encourages companies to:

- provide high-quality customer service;
- reduce customer complaints; and
- get things right first time.

The SIM was first used in the price control set for 2010-15 (PR09), when it successfully incentivised improvements in companies' retail customer service performance.

In '[Setting price controls for 2015-20 Final price control determination notice: policy chapter A2 – outcomes](#)', we explained that, because of the differences in the opening of the business retail market for companies (which depends on the location of their systems)¹, we decided to retain a form of the SIM as a required residential retail service outcome delivery incentive (ODI) for all companies in the 2015-20 period, and adapt it for business retail customers for companies operating wholly or mainly in Wales, as most of these customers would not have access to the same competitive market as those in England. Consequently, for those companies whose systems are wholly or mainly in Wales, we confirmed that two SIMs would apply – one for residential retail customers, which would be applied on the same basis for all companies in England and Wales as the residential retail SIM, and one for business retail customers.

The incentive for Dŵr Cymru is set in '[Setting price controls for 2015-20 Final price control determination notice: company-specific appendix – Dŵr Cymru](#)' under the name 'Non-household retail outcome 1: Business customer satisfaction'. In '[Setting price controls for 2015-20 Final price control determination notice: company-specific appendix – Dee Valley Water](#)' the incentive is set under the name 'Performance commitment F1: Non-household SIM' for Dee Valley Water. For clarity these are both referred to as the 'business retail SIM' throughout this document.

¹ The Welsh Government has, for the time being, chosen not to extend retail competition to all business retail customers by bringing into force relevant parts of the Water Act 2014. Business retail customers of companies operating wholly or mainly in Wales that consume less than 50MI of water a year, and all wastewater customers of these companies, are therefore not able to choose their water retailer.

Further details of both the residential retail and business retail SIMs were published in '[Service incentive mechanism – guidance for collating customer service information for calculating the SIM score](#)' and '[Service incentive mechanism \(SIM\) for 2015 onwards – conclusions](#)'. Further details on the reconciliation of the residential retail SIM were published in the '[PR19 draft determinations: Accounting for past delivery technical appendix](#)'.

Following the acquisition by Severn Trent Water of Dee Valley Water, the instruments of appointment for these companies were modified. This transferred system assets from both companies along the national border in June 2018. This resulted in some customers (including business retail customers) who had been receiving retail services from one of those companies before the modification, receiving those services from the other after the modification. For further information on this see the '[Consultation under section 13 of the Water Industry Act 1991 on proposed modification of Severn Trent Water Limited's \(Severn Trent Water\) licence to include the Powys Site and proposed modification of Dee Valley Water Limited's \(Dee Valley Water\) licence to include the Chester site](#)'. Dee Valley Water was also renamed as Hafren Dyfrdwy. We are therefore completing this reconciliation for Hafren Dyfrdwy.

As set out in the '[PR19 Draft determinations: Accounting for past delivery technical appendix](#)', the reconciliation of the business retail SIM for Hafren Dyfrdwy and Dŵr Cymru will follow a similar approach to the residential retail SIM. The primary differences are that:

- the business retail SIM score is based only on customer complaints data (not customer satisfaction survey data), as set out in '[Service incentive mechanism – guidance for collating customer service information for calculating the SIM score](#)';
- for the years prior to retail market opening in England, all water companies, and for years after market opening, all business retailers in England and Wales, will be used as comparators for the business retail SIM as far as is practicable; and
- the business retail SIM will apply only to Dŵr Cymru and Hafren Dyfrdwy.

The remainder of this document explains how we will calculate the business retail SIM performance payments due to Dŵr Cymru and Hafren Dyfrdwy in section 2, and what the resulting performance payments are in section 3. Section 4 sets out next steps.

2. Methodology for calculating the business retail SIM

2.1 Calculation of the business retail SIM scores

Dŵr Cymru and Hafren Dyfrdwy (and previously Dee Valley Water) have self-reported their business retail SIM scores in their annual performance reports.

Table 1: Self-reported business retail SIM scores from annual performance reports

Water company	2015-16	2016-17	2017-18	2018-19
Dŵr Cymru	83.0	94.3	97.2	97.3
Hafren Dyfrdwy / Dee Valley Water	88.5	90.4	94.0	83.9

These scores are based on the methodology set out in chapter 4 and appendix 1 of ‘[Service incentive mechanism – guidance for collating customer service information for calculating the SIM score](#)’, except including only business retail complaints. This is based on:

- written complaints;
- escalations – complaints that have been escalated in the company and so not resolved at first contact; and
- Consumer Council for Water (CCWater) investigations.

We understand that since 2017 CCWater has focused on improving the reliability of data on total complaints, rather than distinguishing between escalation and first time complaints and so has not separately collected business retail market data on escalations and first time complaints.

We have considered raising a data request to all business retailers in England to collect this data, but we do not consider this to be a proportionate approach, so will not be requesting this data.

We did consider including the escalated complaints data that we have for the ex-incumbent water companies in England pre 1 April 2017 and for Dŵr Cymru and Dee Valley Water / Hafren Dyfrdwy for the whole period. However, doing so would artificially lower these companies’ scores relative to the companies in the business retail market in England post 1 April 2017 and so introduce a bias in the results. We therefore concluded that not using this data would give results closer to the original intention of the outcomes as defined in the PR14 final determinations.

We therefore propose not to include escalated complaints as a separate measure in the calculation of the business retail SIM scores. Escalated complaints are included in the total number of complaints included in the calculation, and so will still be reflected in the overall business retail SIM scores, but with a lower weighting than originally envisaged.

Due to the exclusion of escalations, the self-reported business retail SIM scores in table 1 above differ from those used in our calculation of the performance payments in table 3.

The business retail SIM score is therefore calculated as a quantitative measure based on:

- written complaints; and
- CCWater investigations.

The SIM contact score is calculated using a weighted average of these two components as follows:

$$\text{SIM contact score} = [(5 \times \text{number of written complaints}) + (1,000 \times \text{number of CCWater investigations})] / [\text{number of business retail supply point IDs} / 1,000]$$

The denominator is applied as set out in chapter 5 of '[Service incentive mechanism – guidance for collating customer service information for calculating the SIM score](#)'. This produces a figure for business retail written complaints per business retail connection. This allows comparison between Dŵr Cymru's and Hafren Dyfrdwy's performance, and performance of companies in the business retail market in England, in terms of business retail written complaints per business retail connection.

We are using the data for all companies published on 3 July 2019 by CCWater in '[Non-household customer complaints to water retailers, water companies in Wales, and Consumer Council for Water 1 April 2018 to 31 March 2019](#)', and the equivalent reports from [2015-16](#), [2016-17](#) and [2017-18](#), to determine the performance payments for the final determinations of Dŵr Cymru and Hafren Dyfrdwy.

The resulting SIM score is calculated by converting the SIM contact score into a number out of 100.

The business retail SIM score in each year is then averaged over the years for which data is available for each company. For example, ex-incumbent business retailers in England existed for the years 2015-16 and 2016-17 and so we use an average of

their performance for these two years for the comparison. New business retailers in the market in England have only existed for some of 2017-18 and 2018-19, and so an average of one or both of these years is used to calculate their relative business retail SIM score.

For the purposes of these calculations, we are treating Hafren Dyfrdwy and Dee Valley Water as being the same company. Hafren Dyfrdwy's business retail SIM score is therefore calculated as the average of the score for Dee Valley Water in 2015-16, 2016-17 and 2017-18, and Hafren Dyfrdwy's in 2018-19. This is consistent with the calculation of the residential retail SIM. Dŵr Cymru has existed for all four relevant years, and so also uses a four year average.

2.2 Company comparators

The business retail SIM uses data on companies from the business retail market in England as comparators, in addition to the ex-incumbent water companies pre market opening in April 2017.

Some of the retailers in the business retail market in England are very small relative to Hafren Dyfrdwy and Dŵr Cymru, with low numbers of connections and few or no complaints, as can be seen in table 2. Using these companies as comparators would skew the results and result in less robust results. We therefore think it would be appropriate to exclude companies that do not provide statistically robust comparisons from the analysis. We consider that a company with 2,000 SPIDs is of sufficient size to provide a statistically robust comparator.

We therefore propose to use data on all ex-incumbent water companies for 2015-16 and 2016-17, and all business retail market competitors in England with at least 2,000 supply point IDs (SPIDs – a measure of the number of service connections) for 2017-18 and 2018-19.

Table 2: Number of SPIDs and complaints for business retailers in 2018-19

Company	Number of SPIDs (2018-19)	Number of complaints (2018-19)
ADSM	934	0
Affinity for Business	74,318	146
Business Stream	160,290	400
Castle Water	528,981	2,934
Clear Business	13,607	104

Dŵr Cymru	203,347	560
Everflow	39,971	262
First Business Water	1,326	1
Hafren Dyfrdwy	9,975	23
Leep Utilities	49	0
Pennon	161,969	796
Regent Water	247	0
SES Business Water	38,480	66
Smarta Water	201	0
Three Sixty Water	5	0
TWRC	430	1
Water Plus	830,859	8,067
Water2business	139,522	328
Wave	427,722	2,289
Yu Water	15	0
YWBS	243,343	1,907
Total	2,875,591	17,884

2.3 Application of out / underperformance payments

The out / underperformance payment range will be +6% to -12% of business retail revenues. The top performer (highest business retail SIM score) is notionally awarded a +6% adjustment, and the bottom performer is given a notional -12% adjustment. Dŵr Cymru's and Hafren Dyfrdwy's adjustments are then set proportionally within this range. This is consistent with the approach used for the residential retail SIM.

We propose to calculate the value of the performance payments by multiplying the % adjustment from our assessment by the £ million of actual business retail revenue of the company in 2017-18, and multiplying this by five to establish the value of the performance payment for the 2020-25 period. This £ million figure is calculated in the business retail SIM model published alongside this consultation.

The PR19 financial model will then apply this £ million number to business retail tariffs. The business retail price controls for PR19, which replace the business retail price controls, are set at a tariff level as:

- £ / customer cost; and
- % net margin (bill = (retail cost + wholesale cost) / (1 – net margin)).

We propose that the performance payments are applied as a £ per customer flat charge. We consider this to be a proportionate approach to implementing the reconciliation of the business retail SIM, which balances the complexity of the approach against the impact on customers of different sizes.

2.4 Treatment of Severn Trent Water and Hafren Dyfrdwy

The [‘Decision document: Modification, under section 13 of the Water Industry Act 1991, of Severn Trent Water Limited’s \(Severn Trent Water\) licence and Dee Valley Water Limited’s \(Dee Valley Water\) licence’](#) on modifications of the conditions of the licences of Severn Trent Water and Dee Valley Water, following the respective business reconfiguration in July 2018 set out an allocation of 69.15% of Dee Valley Water’s business retail outcome delivery incentives to Hafren Dyfrdwy (as the successor of Dee Valley) and 30.85% to Severn Trent Water.

We therefore propose that Hafren Dyfrdwy receives 69.15% of the business retail SIM incentive payment. As Severn Trent Water has exited the business retail market, the remaining 30.85% will not be applied to Severn Trent Water, consistent with the proposals set out in the [‘Consultation under section 13 of the Water Industry Act 1991 on proposed modification of Severn Trent Water Limited’s \(Severn Trent Water\) licence to include the Powys Site and proposed modification of Dee Valley Water Limited’s \(Dee Valley Water\) licence to include the Chester site’](#).

3. Business retail SIM payments for Dŵr Cymru and Hafren Dyfrdwy

Table 3 shows the business retail SIM scores and performance payment adjustments for all business retailers. The notional adjustments are shown for comparative purposes, as the adjustments are calculated based on relative business retail SIM scores as described above. The actual adjustments are shown for the Welsh companies that have a business retail SIM outcome delivery incentive. There will be no adjustment for companies operating in England.

Table 4 shows how these adjustments translate into the £ million values to be applied to the PR19 price controls for Dŵr Cymru and Hafren Dyfrdwy. The approximate annual impact per SPID (an approximation of customer numbers) for Hafren Dyfrdwy is £1.88 and for Dŵr Cymru is £0.64 for 2020-25.

Table 3: Business retail SIM scores and resulting adjustments as % of 2017-18 actual business retail revenue

Company	Business retail SIM score	Notional business retail SIM adjustment	Actual business retail SIM adjustment
SES Water	99.3	6.00%	N/A
Hafren Dyfrdwy / Dee Valley Water	98.7	5.53%	5.53%
Portsmouth Water	98.4	5.31%	N/A
Wessex Water	98.2	5.17%	N/A
SES Business Water	98.0	5.00%	N/A
South East Water	97.9	4.90%	N/A
South Staffs Cambridge	97.9	4.88%	N/A
Water2business	97.2	4.33%	N/A
South East Water Choice	97.0	4.18%	N/A
Bournemouth Water	97.0	4.16%	N/A
Bristol Water	96.9	4.03%	N/A
Affinity for Business	96.8	3.95%	N/A
Affinity Water	96.7	3.91%	N/A
Business Stream	95.6	2.96%	N/A
Severn Trent Water	95.4	2.84%	N/A
Thames Water	94.9	2.45%	N/A
Dŵr Cymru Welsh Water	94.1	1.77%	1.77%

Company	Business retail SIM score	Notional business retail SIM adjustment	Actual business retail SIM adjustment
Northumbrian Water	93.6	1.31%	N/A
Yorkshire Water	93.5	1.31%	N/A
South West Water	93.5	1.30%	N/A
Yorkshire Water Business Services	93.3	1.11%	N/A
Clear Business Water	93.3	1.10%	N/A
Castle Water	91.8	-0.09%	N/A
Southern Water	91.5	-0.38%	N/A
Anglian Water	90.7	-1.05%	N/A
Pennon	90.4	-1.26%	N/A
Wave	89.6	-1.93%	N/A
Water Plus	87.8	-3.41%	N/A
United Utilities	85.2	-5.55%	N/A
Everflow	77.3	-12.00%	N/A

Table 4: Business retail SIM adjustments in £ million (nominal prices)

Company	£ million value of adjustment (2020-25 total)
Dŵr Cymru	0.651
Hafren Dyfrdwy	0.094

Note: figure for Hafren Dyfrdwy is after multiplying by 69.15% to calculate the company's share of the performance payment.

4. Next steps

We welcome views on the proposed approach set out in this consultation. Consultation responses should be submitted by **10 am on 4 September 2019**, or alongside representations on the draft determinations by 10 am on 30 August 2019.

We will consider responses to this consultation when reconciling the business retail SIM in the PR19 final determinations for Dŵr Cymru and Hafren Dyfrdwy in December 2019. Note that the business retail SIM will not be carried forward into the 2020-25 period, as business customers will be protected by new performance commitments. The business customer satisfaction performance commitment for Dŵr Cymru and the non-household customer satisfaction performance commitment for Hafren Dyfrdwy will ensure that these companies are incentivised to continue to provide high-quality customer service to business customers.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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