

December 2019

PR19 final determinations

Business Retail Market Representations

PR19 final determinations: Business retail market representations

In response to our draft determinations we received several representations from retailers (including the UK Water Retailer Council, (UKWRC)) who are active in the business retail market across England and Wales. The representations raise issues in relation to some of the bespoke performance commitments proposed by some wholesalers. They also touch upon some issues that are not captured by our 2019 price review (PR19) decisions. This appendix addresses the points raised in these representations. It is also intended to help retailers and self-suppliers, business retail customers and other market participants easily identify where wholesalers have bespoke performance commitments in place that interact with the business retail market.

It is worth noting that our PR19 decisions include 15 common performance commitments, which are commitments with standardised definitions that all companies must have. Most of these common performance commitments apply to the provision of wholesale services, which are provided to both residential retail and business retail customers¹. The common performance commitments are not discussed in detail in this appendix, but the definitions can be seen in each company's 'Outcomes performance commitment appendix'.

¹ Priority services register, Per Capita Consumption, C-MeX and D-MeX are common PCs that exclusively relate to residential retail and developer services customers respectively.

How is the remainder of this document structured?

The remainder of this document is structured as follows:

1. Wholesaler and retailer coordination – PR19 and beyond
2. Representations on bespoke performance commitments in our draft determinations
3. Representations relating to other issues

1. Wholesaler and retailer coordination – PR19 and beyond

The business retail market expanded in April 2017. Business customers with eligible premises in England and Wales can choose their retailer. Business retailers can serve customers anywhere in England and Wales but wholesale services continue to be provided by incumbent companies (wholesalers). This means that a business retailer serving business customers across England and Wales will need to engage with up to 17 different wholesalers. We have identified cumbersome wholesaler-retailer interactions as one of three main market frictions², which are currently undermining the more effective operation of the business retail market in England and Wales.

It is important that wholesalers with bespoke performance commitments relevant to the business retail market take action to avoid the risk that these bespoke performance commitments exacerbate the problems created by cumbersome wholesaler-retailer interactions. We talk about this in relation to specific performance commitments below. There are a number of initiatives aimed at improving wholesaler-retailer interactions in the market, such as those led by the Retailer Wholesaler Group (RWG) and MOSL (the market operator for the business retail market). We support the work being taken forward by the RWG and expect wholesalers to be monitoring developments in this forum and adopting agreed RWG guidance³. We are also very supportive of the commitments set out in MOSL's [Market Performance Operating Plan \(MPOP\)](#), such as its aim to match market vacancy to its true level. At the end of the first year of the business retail market the number of premises recorded as vacant stood at 171,397. As of 1 November 2019 this number has increased to 270,423. We are concerned that there may be a significant number of premises incorrectly recorded as vacant. Ultimately this could be having a detrimental impact on accurate settlement in the market. As such we encourage wholesalers and retailers to work constructively with MOSL to deliver its vacancy objectives.

A significant amount of planning goes into the development of companies' water resources management plans (WRMPs) and business plans. The business retail market in England and Wales is operational and starting to mature so we strongly

² The other two main market frictions are: poor quality market data; and poor wholesaler performance. More details on the state of the business retail market in England and Wales can be found in our [State of the Market report](#), published July 2019.

³ We are reviewing the extent to which wholesalers are adopting RWG guidance as part of our [review of incumbent company support for the development of effective markets](#).

encourage wholesalers to start thinking ahead to the next price review and how they can work effectively with retailers where appropriate in developing their WRMPs for the next price review (PR24). A common concern we hear from retailers since the business retail market opened is that they often feel overwhelmed by the number of consultations and requests for feedback issued by wholesalers. With this in mind we ask wholesalers to consider the most efficient and effective way to engage and work with their retailer customers in the lead up to the next round of water resources management planning and the PR24 price review. We also strongly encourage retailers to engage and work with wholesalers, business retail customers and other relevant stakeholders at the appropriate points, including to help to ensure that the needs of business customers are reflected in future WRMPs and PR24 business plans.

Effective water resource planning is essential to ensure the long-term balance between supply and demand is maintained. Every five years, WRMPs set out a company's intended approach for at least the next 25 years. WRMPs were last updated and finalised by wholesalers this year (2019). The next update to these plans is due in 2024 (WRMP24). However, in practice, work on preparing these plans will need to begin well in advance of that date with the Water Resources National Framework expected to be published early in 2020. We expect wholesalers to work with business retailers where appropriate in developing their future plans.

WRMP24 – Indicative timetable

Date	WRMP activities
Early 2020	Water Resources National Framework published
Nov – Dec 2020	Water Resource Planning Guidelines published
Jan 2022	Companies conduct pre-consultation of draft WRMPs
Aug 2022	Companies submit draft WRMPs to Defra
Sep – Dec 2022	Consultation on draft WRMPs
Sep 2023	Final WRMPs published

2. Representations on bespoke performance commitments in our draft determinations

In the following section we look at some of the representations that we have received in response to our draft determinations, specifically where retailers (or the UKWRC) raised issues or concerns in relation to proposed bespoke performance commitments.

In setting out our response to these points we highlight if we make any changes to bespoke performance commitments in the final determinations. For all of the performance commitments discussed in this section, further details are available within each company-specific outcomes performance commitment appendix and in our 'Delivering outcomes for customer's policy appendix'.

2.1 Retailer satisfaction

2.1.1 Our draft determinations

In the revised business plans four companies proposed bespoke performance commitments relating to the satisfaction of business retailers (Bristol Water, Thames Water, South Staffs Water, and Anglian Water). In the draft determinations we removed two due to poor definitions (Bristol Water and Thames Water) and changed Anglian Water's performance commitments to reputational only. We accepted South Staffs Water's performance commitment, which was reputational only.

2.1.2 Stakeholder representations

Representations from retailers want us to introduce a common measure to better incentivise the services provided by wholesalers to retailers. One representation notes that the PR19 C-MeX and D-MeX mechanisms include financial and reputational incentives, which should encourage wholesalers to deliver improved levels of service to residential retail and developer services customers. But concerns were raised that no equivalent measure would be introduced for retailers.

One respondent notes that the RWG was trying to develop 'R-MeX', a measure intended to measure the quality of service that wholesalers provide to retailers. The respondent suggests that R-MeX should be adopted as a common PC for all wholesalers with a clear financial and reputational mechanism behind it.

2.1.3 Our assessment, reasons and final decision

In our final determinations we retain our draft determination decisions, with **Anglian Water** and **South Staffs Water** both having reputational bespoke performance commitments focussed on retailer service satisfaction.

We acknowledge the points raised regarding C-MeX and D-MeX, specifically in relation to the reputational and financial incentives that both of these mechanisms provide for wholesalers to improve service to residential retail and developer services customers.

The RWG has developed an 'R-MeX' incentive, which has already been piloted and which we expect to be incorporated in the market codes in time to be implemented as a reputational common measure for all wholesalers from April 2020. Earlier this year we published a report "[Strengthening wholesaler performance and service in the business retail market](#)". In that report we noted the importance of monitoring the impact and effectiveness of the reputational R-MeX incentive from April 2020. Furthermore, "we note that residential customer (C-MeX) and developer (D-MeX) measures of satisfaction will include financial incentives for under and out performance from April 2020. It may be appropriate for the (R-MeX) measure to include financial incentives over time".

MOSL is currently leading a review of the Market Performance Framework (MPF). This review is considering how the existing incentive framework can be improved, so that it delivers effective market functioning and acts as a driver for continuous improvement. We consider this review provides an opportunity for the MPF to be developed in such a way to better incentivise wholesaler performance and service. This could include making R-MeX a financial incentive over time.

2.2 Gap sites and voids

2.2.1 Our draft determinations

Voids are properties classed by water companies as being vacant. However, some voids are actually occupied, so they may be erroneously billed, that is, either too little or nothing at all. A gap site⁴ is a property where water and/or wastewater services are being consumed, but the property is not on a water company's system and is therefore not billed.

In our draft determinations seven companies proposed bespoke performance commitments which focussed on reducing the number of gap sites or void properties in the business retail market, which are occupied but not billed. The intention of these performance commitments is to provide fairer charges for customers and lower bills for customers already paying.

⁴ Such sites are sometimes referred to as 'missing properties' in the residential market. We use the term 'gap site' to cover both the residential and business markets.

2.2.2 Stakeholder representations

Retailer representations mainly focus on the voids performance commitments, but some raise issues in relation to the gap site performance commitments.

Representations to the draft determinations note that, at present, only a handful of wholesalers elect to apply volumetric charges to vacant properties in the market.

Concerns are raised that:

- The proposed voids performance commitments will make it more likely that wholesalers will charge for vacant sites.
- The charges imposed by wholesalers for vacant properties might be disproportionate or potentially illegal.
- Retailers have inherited poor quality customer data from wholesalers at market opening and will now be (more) liable for charges from business customers who are difficult to trace.
- Gap site and voids performance commitments are inconsistent in process, design and incentive rates.
- Wholesalers might not share financial incentives with retailers, despite the costs of bringing vacant sites into charging potentially being incurred by retailers.

One representation proposes that we temporarily suspend the introduction of the PR19 incentives and charges for vacant properties until an industry-wide solution is agreed. On this point it is worth noting that in its response to the draft determinations United Utilities says that it would be willing to change its voids and gaps performance commitments to be consistent with a common industry approach.

2.2.3 Our assessment, reasons and final decision

In our final determinations, we confirm that the following companies will have bespoke performance commitments relating to the reduction of voids and/or gap sites in the business retail market.

Northumbrian Water (Gap sites)

SES Water (Voids)

Severn Trent Water (Voids and Gap sites)

South East Water (Voids)

Thames Water (Voids)

United Utilities (Voids and Gap sites)

Wessex Water (Gap sites)

In our final determinations, we have provided clarification on our approach towards these performance commitments. We recognise that retailers operating in the business retail market may deal with a number of different wholesalers at any one time, so there is a risk that bespoke performance commitments could exacerbate

market frictions in the business retail market from cumbersome wholesaler-retailer interactions. To mitigate against this risk the RWG is currently developing a set of consistent processes for implementing financial incentives relating to business gaps sites and voids. We expect wholesalers to adopt the processes developed by the RWG and play an active role to ensure such processes are developed and implemented by April 2020. In April 2020 we will ask each of the wholesalers with bespoke incentives on gaps or voids to set out the steps they have taken to ensure that the introduction of these bespoke performance commitments will not exacerbate problems associated with wholesaler-retailer interactions. Where relevant wholesalers do not voluntarily adopt the processes developed by the RWG, we will consider proposing a code modification to formally implement them.

It is possible that, at some time during the 2020-25 period, a common financial incentive on gaps and/or voids is developed by market participants (for example this could be developed at part of the reform of the MPF). If industry was planning to introduce a common financial incentive on business voids under the MPF, we would consider, following consultation with those companies which have bespoke performance commitments on business retail gaps and voids, the appropriate way to take such a measure into account in their future in-period determinations. For example, this could result in us amending the revenue adjustment we make during an in-period determination for the bespoke performance commitments on business voids to zero or netting off the market initiated financial measure against out / underperformance payments to avoid duplication.

With regard to the concerns raised in relation to the charging levels that wholesalers could apply to vacant properties, we are considering this point as part of our ongoing **review of incumbent water company support for the development of effective markets**. As part of this review we have asked wholesalers to confirm their charging policies in respect of vacant sites and premises from 1 April 2020. We intend to publish wholesaler responses on our website early in 2020.

Principles for determining the amount of charges (as set out in Ofwat's Wholesale Charging Rules)

Consistent principles and methodologies must be applied to the calculation of charges for different classes of Eligible Premises, regardless of the services provided.

Charging structures must reflect the long-run costs associated with providing the relevant service.

Differences between charges for services provided to Eligible Premises that are larger users of water and sewerage services and charges for services provided to

Eligible Premises that are smaller users of water and sewerage services must only be based on cost differences associated with differential use of network assets, differential peaking characteristics, different service levels and/or different service measurement accuracy.

Where cost differences associated with differential peaking characteristics are used as a basis for differences between charges for services provided to Eligible Premises that are larger users of water and charges for services provided to Eligible Premises that are smaller users of water, the charges fixed on that basis must be structured on an appropriate peak demand basis.

Charges for sewerage services must take into account the different pollutant loads associated with foul water, trade effluent, surface water draining from Eligible Premises and surface water draining from highways.

2.3 Metering commitments

2.3.1 Our draft determinations

A number of companies propose the delivery of significant smart meter programmes within their business plans. These programmes include both new smart meter installations and the replacement of existing meters with smart meters. In theory, smart meters can reduce the cost of meter readings and allow for more regular readings to be taken. This improves the quality of data for the customer to better control their use, and for companies to effectively manage demand. The inclusion of smart metering programmes in business plans is a result of the water resources management planning process, which identify options to increase supply and reduce demand. Companies determine a best value plan that ensures that they can maintain the supply-demand balance and provide drought resilience. In order that customers are adequately protected from partial or non-delivery of the smart metering programme we intervened at the draft determinations to ensure the companies had appropriate smart metering performance commitments. We allow a substantial enhancement expenditure allowance to some companies, beyond their base maintenance allowance, for this programme of work in our final determinations. Therefore these performance commitments ensure that these enhancement costs will be recovered for customers if a company does not deliver or partially delivers the programme.

2.3.2 Stakeholder representations

One retailer notes that poor or absent metering data is one of the most significant issues affecting business customers. It proposes that we extend the scope of all bespoke performance commitments relating to metering programmes to include business properties. It argues that this could potentially contribute towards addressing the current shortage of metering capacity in the business retail market. Though it is worth noting that, from our engagement with other retailers in the market, we have heard different concerns in relation to plans to roll out smart meters. One retailer advises us that it is concerned by the potential costs to retailers associated with acquiring data from smart meters and believes that this could be much more expensive than bi-annual visual reads.

2.3.3 Our assessment, reasons and final decision

Ahead of publishing our final determinations we issued some queries to wholesalers with bespoke performance commitments relating to metering roll-outs or replacements. In some cases, we wanted to clarify if companies only intend to include residential retail properties within their programmes. We also used this opportunity to ask companies to clarify their general approach with respect to business retail meters within their specific service areas.

Anglian Water has indicated to us that its smart metering programme will be replacing both residential retail and business retail meters within its area. The performance commitment in Anglian Water's final determination has been revised to reflect this.

Northumbrian Water has confirmed that its smart metering programme is focused on residential retail customers and therefore we have not revised its performance commitment (focus of smart metering is the Essex and Suffolk region). However, we note that the company intends to encourage a move to smart meter on replacement of meters at end of life (business as usual replacement) for business retail customers.

Severn Trent Water's smart metering programme is just focused on residential retail customers, but similar to Northumbrian Water, it intends to use smart meters for business retail customers where feasible, on new installations and where meters are replaced. We therefore have not amended this performance commitment.

South West Water has confirmed that its smart metering programme will encompass the replacement of residential retail and business retail meters. We understand that South West Water's approach is focussed on the replacement at end of meter life rather than the pro-active replacement by geographical area. We therefore have not amended this performance commitment.

Thames Water has indicated that it intends to install smart meters on business retail properties within its smart meter roll out area. Thames Water has not specified but it appears this may be on meter replacement basis (possibly at end of life). It also appears that company policy is to install smart meters on business retail properties where feasible, at new connections and on replacements. However, we have not changed Thames Waters performance commitment definition because the enhancement allowance we make is in response to the company's request that is specifically related to residential retail meters.

Aside from the revision to Anglian Water's performance commitments, we have not found sufficient and convincing evidence to remove the exclusion for the other companies that have bespoke performance commitments focussed on residential retail customers. As noted above, several wholesalers have indicated that they intend to roll-out or upgrade existing business retail meters as part of their business as usual activities. Removing the exclusions for these performance commitments could potentially enable wholesalers to achieve performance commitment levels through activities that they already have planned as standard day-to-day operations. This would effectively make the performance commitment levels easier to achieve, which is not in customers' interests. However, this is an issue that we are willing to explore further with market participants in the future – for example by looking at ways to encourage a prioritised roll out of smart meters and consider where industry incentives might have a role to play.

3. Representations relating to other issues

In the following section we set out and respond to some of the other points that retailers raised in their representations.

3.1 Business customer satisfaction

Several representations were received from retailers who wanted to measure and better incentivise the services provided by wholesalers to business customers. It was noted again that PR19 includes such incentives for residential retail customers and developer services customers in C-MeX and D-MeX, but it was suggested that nothing similar has been put in place for business customers. The respondents proposed that we introduce a 'B-MeX' measure for business retail customers of wholesalers, with performance metrics drawn from a range of sources, such as complaints about wholesalers, data quality, and feedback from customer satisfaction surveys.

3.1.1 Our response

In principle, we see merit in the suggestion raised by retailers. We recognise the importance of wholesalers being incentivised to provide high levels of service in areas that impact the experience of business customers, particularly in relation to the specific services that they are responsible for (e.g. meter installation, meter repairs, data logging services, etc.).

Rather than using PR19, we consider it would be more appropriate to introduce a B-MeX measure within the framework of market codes. Such measures do require a lead-in time, as the measure is developed and trialled. As mentioned above, a review of the MPF is currently underway. We consider that the review provides an opportunity for the MPF to be updated so that it captures, measures and better incentivises more aspects of wholesaler performance in the business retail market.

It is also worth noting that as part of our ongoing [review](#) of incumbent water company support for the development of effective markets, we have asked wholesalers to explain what action they currently take to understand the experiences of end customers in consuming their services.

3.2 Water efficiency

It was noted that common performance commitments will incentivise wholesalers to reduce the per capita consumption of their residential retail customers, but not for

business retail customers. It was proposed that we extend performance commitments relating to water efficiency to include business customers. It was also suggested that the Retail Exit Code (REC) price protections⁵ for small and medium-sized enterprise (SME) customers provide limited bandwidth for retailers to encourage customers to reduce their water consumption without any wholesaler incentive.

3.2.1 Our response

We agree that the business retail market has a key role to play in encouraging business customers to take up better water efficiency and leak reduction services, leading to lower consumption levels, as well as associated environmental benefits. The market is not yet delivering the levels of water efficiency anticipated at market opening although some customers are making significant savings - for example three self-suppliers saved around 150MI of water between them last year - and Business Stream has recently committed to helping its business customers reduce water consumption by 20%. Market frictions, in particular, poor quality consumption data, may also hinder the realisation of higher levels of water efficiency being achieved in the short term.

We do not consider it practical or appropriate to extend the per capita performance commitment for per capita consumption to business customers for the reasons set out below. We consider that it is more appropriate to continue working with industry to resolve market frictions as a first and essential step towards enabling greater water efficiency goals.

- the per capita performance commitment is calculated on a per person basis. Business retail customers vary considerably in their levels of water use and their potential to make savings to this, so it would not be feasible to develop a new common performance commitment for business customers at this advanced stage of the price review, due to data quality issues and the inherent challenges with setting levels and rates; and
- a key benefit of using markets (rather than regulation) to deliver improved outcomes for customers is that markets can incentivise companies to innovate to win market share. If we intervene to determine the level of water efficiency that must be delivered by the market, this risks distorting the market, as companies focus on meeting the regulator's requirements rather than customers'.

⁵ [Future protections for business retail customers: Decision on Retail Exit Code – price protections](#)

However we are keen to work with MOSL, wholesalers and retailers to consider whether there are any mechanisms or incentives in the business retail market that might help to promote water efficiency.

As part of our PR19 decisions, we have made an allowance for companies to deliver water efficiency, as part of a twin track approach to maintaining their supply-demand balance and ensuring resilience to drought. While we are aware that companies have costed their water efficiency programmes based on an assumed set of activities (e.g. residential retail visits and distribution of water saving devices), they still have the discretion on how to spend these funds most effectively providing that they maintain the supply-demand balance.

Companies and regulators are already working on the development of the next update to WRMPs that will set out how the supply-demand balance will be maintained from 2025 onwards. These WRMPs plan for a minimum of 25 years and identify the demand management and new supply options required to ensure resilience to drought. It is worth noting that section 6.3 of the latest [WRMP guidance](#) advises wholesalers to consider proposals from third parties for managing supply and demand. Retailers who intend to deliver water efficiency as part of their business model might see this as an opportunity worth exploring. The water bidding market information on [our website](#) provides a good overview and links for third parties that want to offer services to a company to help it to maintain its supply-demand balance.

3.3 Data quality

Several retailers consider that there should be clearer incentives for wholesalers to improve market data. For example, one respondent suggests that at the time of market opening a significant number of properties were wrongly identified as vacant. It was noted that retailers have initiated data cleansing activities, but it was suggested that these activities would fall short of fixing the issue in the near future. The Data Improvement Plans initiated by MOSL during the early stages of the market are referenced, but it is suggested that several key data items were excluded from these plans and a more holistic approach is needed to address data issues in the market.

3.3.1 Our response

We agree that poor data quality is a key market friction. A lack of complete, accurate and timely market data - particularly meter reads – impedes parties' ability to trade effectively. Poor data also leads to inaccurate or disputed billing and can undermine water efficiency measures.

In our [state of the market report for 2018 - 2019](#) we noted that market parties, working with MOSL have made some improvements to data quality. For example, MOSL increased its focus on improving the accuracy of data held in the central settlement CMOS database, including through cooperation with retailers and wholesalers. MOSL and the Industry Panel have proactively undertaken work to identify and work with trading parties to improve data quality. However, significant data quality issues remain.

As noted above, MOSL is leading a review of the MPF. We consider this could be a more appropriate framework to incentivise improved data quality in the business retail market. We also note that MOSL has engaged the sector with the aim of developing a central bilaterals solution for the market – that is, a central solution that aims to significantly improve the quality and standardisation of bilateral engagement and integration between wholesalers and retailers. We are fully supportive of the development of such a solution to help resolve market frictions. The delivery of this solution should reduce the need for manual reconciling of data issues and also contribute towards overall improvements in data quality.

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales.

Ofwat
Centre City Tower
7 Hill Street
Birmingham B5 4UA

Phone: 0121 644 7500
Fax: 0121 644 7533
Website: www.ofwat.gov.uk
Email: mailbox@ofwat.gov.uk

December 2019

© Crown copyright 2019

This publication is licensed under the terms of the Open Government Licence v3.0 except where otherwise stated. To view this licence, visit nationalarchives.gov.uk/doc/open-government-licence/version/3.

Where we have identified any third party copyright information, you will need to obtain permission from the copyright holders concerned.

This document is also available from our website at www.ofwat.gov.uk.

Any enquiries regarding this publication should be sent to us at mailbox@ofwat.gov.uk.

