

To:
Rachel Fletcher, CEO, Ofwat

CC:
Emma Kelso, Senior Director, Customers and Casework, Ofwat
Georgina Mills, Director, Business Retail Market, Ofwat
Sarah McMath, CEO, MOSL
Steve Arthur, Market Performance Director, MOSL

30 August 2019

Dear Rachel,

Ref: PR19 Draft Determinations – UK Water Retailer Council Response

Thank you for giving us the opportunity to provide our comments on PR19 Draft Determinations issued by Ofwat on 18 July 2019.

It has now been more than two years since the business retail market opened to competition, and as highlighted in Ofwat's State of the Market issued on 11 July, significant barriers to the market operating effectively remain. Non-household customers have experienced a number of problems with the operation of the new market, with issues such as market data leading to an increased level of complaints.

All market participants have a role to play in achieving the necessary improvements to address market frictions but performance of wholesalers against industry standards have had a significant impact on customers' experience of the market, and we strongly support Ofwat's push for a step change in wholesalers' efficiency as part of PR19.

However, we are concerned that little in wholesalers' Draft Determinations seems to be focussed on the non-household market, in particular regarding a) the issue around charging for vacant properties (as opposed to vacant incentives) and b) the incentives required to improve wholesale service provided to business customers. These two areas are critical for a more efficient and well-functioning non-household market, and we have provided below suggestions on how this could be addressed in the coming months.

Vacant Properties

Context

The fundamental issue around vacants relates to a) the significant number of properties registered in the market as vacant which may actually not be vacant (and for which some consumption is being registered) and b) more broadly to the charging methodology for properties identified as vacant. It should be noted that this issue has existed well before market opening, but at that time there were limited incentives for wholesalers to bring these properties into charge (given price control revenue caps) and little had been done prior market opening to address this issue.

Whilst the regulatory framework for vacant charging has not changed since market opening (i.e. wholesalers still have three options with respect to charging for vacant properties including a) no charges apply, b) charges are applied for consumption only, c) all charges apply), several wholesalers have included in their PR19 Business Plan a proposal to introduce an incentive mechanism for vacant properties, which significantly increases the likelihood of wholesalers charging retailers for vacant properties from 1 April 2020. (At the moment only a handful of wholesalers have elected to apply volumetric charges to vacant properties).

Data Cleansing

As mentioned above, it seems likely that a significant number of properties are wrongly identified as vacant and this significantly increases retailers financial exposure if/when wholesalers start applying volumetric charges on vacant properties. To address this, most retailers have initiated data cleansing activities, with the intention to reduce the number of properties wrongly identified as vacant. These activities are costly and given the scale of the task, are likely to fall significantly short of 'fixing' the issue by April 2020 (i.e. a significant number of properties will still be wrongly identified as vacant on 31 March 2020).

Charging Methodology

Moreover, and even in the hypothetical (and highly unlikely) scenario where 100% of the data is fixed by 1 April 2020, the issue around wholesale vacant charges will remain given: a) the regulatory framework (i.e. wholesalers are allowed to apply all charges for vacant properties, including fixed charges for unoccupied properties), b) the fact that PR16 economic cost allowances have not made any account of the higher cost of serving vacant properties (e.g. lower collection rate, cost of cleansing the data) and c) the legal situation in England and Wales (see below).

Legal Considerations

The 2014 Water Industry Act places the legal burden for the payment of water charges on the 'occupier' of a property and as Ofwat has in the past determined, it is far from clear whether water suppliers have any right to recover charges from a property which does not have an occupier (which differs to Scotland for example where the law makes specific provision for the recovery of charges from property owners). As highlighted in our letter to Ofwat sent on 9 July 2019, it seems highly unreasonable for any vacant charging scheme in England to require retailers to pay wholesale charges on a property for which it has no legal right to recover charges from a 'customer'.

Our Proposal

Whilst we support the introduction of an incentive framework to reduce the overall number of properties incorrectly registered as vacant in the market, retailers would be heavily impacted by the introduction of vacant charging across all regions and UKWRC members do not feel there has been enough engagement at market level to fully understand the nature of the problem.

Moreover, retailers are already financing a large part of the solution (via data cleansing) without any financial or commercial recompense for it, and Ofwat's proposal to incentivise wholesalers to bring vacants into charge seems very much as a 'win-win' situation for wholesalers (i.e. reward for bringing vacant into charge + future financial benefit) and a 'lose-lose' situation for retailers (current cost to cleanse the data + future financial exposure).

Considering the issues raised above, our proposal is to temporarily suspend wholesale charges for vacant properties (for 1 or 2 years), to allow time for the development of a market-wide solution. It may be that this would also require a temporary suspension of the wholesaler incentives within PR19. We don't believe that this would have any significant financial implications for the wholesalers, and this would allow the industry, along with Ofwat and MOSL, to build on the work already underway to complete a robust and thorough analysis of the properties identified as vacant in CMOS, in order to a) establish the origin and the cause of vacant properties, b) understand regional variations, and c) propose a holistic incentive framework that takes into account the challenges of both wholesalers and retailers at a market level.

Wholesalers Incentives for NHH Market

Context

More than two years since the competitive market opened, our members have noted that apart from the OPS framework, there is no effective wholesaler incentive mechanism in place in relation to the business retail market, nor is there a committed timeline to develop one.

As mentioned in a previous letter sent by the UKWRC on 18 September 2018, whilst an upgraded version of the OPS framework is very much needed, it is also essential that a more holistic incentive framework is in place to measure wholesaler's performance at both the customer (i.e. end-user) and business retailer level, and we have set out below in more detail the two pillars of such incentive framework – i.e. 'B-Mex' and 'R-Mex'.

Business Customer Measure of Experience or 'B-Mex'

We were very supportive of Ofwat's introduction in PR19 of a Customer Measure of Experience (C-Mex) with appointed companies which intends to measure service performance with domestic customers.

However, we were disappointed to not see anything replacing the SIM, and we are proposing that a B-Mex is introduced to cover the services provided by wholesalers to business retail customers. The B-Mex could address for non-household customers similar areas covered by C-Mex for the household market, including a mix between customer surveys and performance metrics on key areas. This scheme will ensure transparency, drive and innovation on the part of wholesalers to improve outcomes for non-household customers.

Building on the positive impact and experience of such mechanisms in other areas, such a mechanism would need to deliver robust incentives to be fully effective (rewarding good performance with penalties for poor performance). This should be a combination of both financial and reputational incentives and we have set out below some key areas to consider for B-Mex:

- **Complaints figures:** Business retailers have to submit monthly and annual complaints figures to CCWater, including a breakdown between retail, mixed and wholesale complaints. The level of wholesale and mixed complaints is therefore easily available and should be one of the key metrics of a future B-Mex framework. This would highlight differences in a number of areas impacting on customers, such as wholesaler policies, delivery of customer facing services such as meter exchanges and more.
- **Data quality:** Key market data areas (such as meter location) should be one of the primary areas of focus of the future B-Mex, and this should have a positive impact on the quality of market data. As mentioned in the letter sent by the UKWRC to Ofwat on 20 March 2019, we support the on-going work led by MOSL to improve market data, in particular the Data Improvement Plan (DIP), which will help in reducing market frictions and improving customer outcomes. However, key data items are excluded from the DIP and a more holistic approach is strongly recommended with clear incentives for wholesalers to improve market data.
- **Water efficiency:** We have noted that common 'Performance Commitments' have been introduced as part of PR19 on all wholesalers to reduce the per capita consumption of their household customers, but unfortunately there is currently no equivalent for business customers. UKWRC members have highlighted that based on their water consumption, business customers' contribution to the Government's water conservation objectives should be significant. Given the REC restriction on SME customers, there will be limited bandwidth for retailers to encourage customers to reduce their water consumption without any wholesaler incentive.
- **Gap site:** We were pleased to see that the issue of 'gap sites' was being addressed as part of PR19. However, we were disappointed that wholesalers did not engage more with retailers to understand the economics of a gap incentive scheme that also works for retailers. We would like to see in PR19's Final Determinations how the incentive payments would flow through to retailers and that the value and approach is consistent across wholesalers' regions. In the Scottish market retailers have played a significant role in identifying gap sites and have contributed to the success of the scheme to date. We would urge Ofwat to ensure that wholesalers' Business Plans address both wholesaler and retailer incentives, to avoid the risk for the market to subsidise customers who do not pay for water and wastewater services.

- **Customer Survey:** Similar to what C-Mex covers with domestic customers, we would strongly suggest that B-Mex includes a survey on a group of business customers to measure their general satisfaction with wholesalers. This would drive better wholesale customer service and ensure key areas of customer concerns are captured and measured by wholesalers. We have a number of ideas on how to practically implement this as part of the AMP7 period, and we would be very happy to further engage with Ofwat on this.

Considering the current stage of the PR19 process, a relatively simple way to introduce the B-Mex would be to extend some of the common Performance Commitments to include business customers (which could be part of the ODI reconciliation process planned during Autumn).

Business Retailer Measure of Experience or 'R-Mex'

Monitoring business retailers' satisfaction with wholesalers would drive better wholesale performance to improve customer outcomes, and as such we strongly support the on-going discussions at the Retailer Wholesale Group (RWG) to create an 'R-Mex' measure.

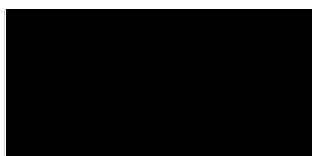
It should be noted that only a handful of wholesalers have made some commitment in relation to a business retailer measure of experience in their PR19 Business Plans. As the interaction between wholesalers and retailers plays such a critical role in the competitive market, the R-Mex should be a common performance commitment for all wholesalers, with a clear financial/reputational incentive mechanism behind it.

To date progress has been slow and we would urge Ofwat and MOSL to play a more active role in coordinating with wholesalers and business retailers the implementation of such a measure. (Given that there is will no direct financial impact on wholesalers it could easily be implemented outside the PR19 process).

We would be very happy to work with MOSL and Ofwat to develop our ideas further, so please don't hesitate to contact me if it would be useful to have a meeting to discuss it.

I look forward to hearing from you at your convenience.

Yours sincerely,



Phill Mills
Chair, UK Water Retailer Council