

To:
Emma Kelso, Senior Director, Markets and Enforcement, Ofwat

By email

31st October 2019

Dear Emma

Incumbent water companies and the development of effective markets.

Thank you for the opportunity to respond to your letter to incumbent water company wholesalers.

UKWRC members value your recent and more proactive questioning of both wholesalers' attitudes to the retail market and their behaviours in addressing the current issues and frictions in the market. That said, we believe there would be benefit from greater engagement and direction from the regulator to help resolve the key policy issues currently holding back development of a well-functioning market

It is not our intention in this response to go through each of your questions, many of which are applicable only to wholesalers, or to repeat some of the specific concerns of individual retailers. We do however make a proposal to help drive improvements to the business retail market and improve outcomes for customers.

We previously shared with you the UKWRC letter to the CEOs of all wholesalers. We took this upon ourselves to set out our common concerns directly to the CEOs, in the absence of any consultation or proactive engagement with retailers following Rachel Fletcher's letter of 28th May. Despite follow up calls with the PAs of all CEOs we have received only 6 responses to the 16 letters sent. Those that have responded have generally accepted the issues we raised and have shown willingness to meet and engage with us. Whilst this is welcomed, and we will respond positively to them, it would be impractical to meet with 6 wholesalers on an individual basis and to achieve a consensus cross-sector view of what is required.

To take this willingness to engage to the next level and make progress on the issues we have identified, UKWRC members believe a series of facilitated workshops or a high-level policy forum of wholesaler and retailer representatives is needed. We believe there was such a group prior to market opening. Such an approach could address the issues that are outside the scope of MOSL or current market groups, especially within the current governance arrangements. And whilst we accept the RWG is addressing some issues through guidance, these are at an operational rather than policy level and the guidance is not adopted consistently across wholesalers.

UKWRC members believe Ofwat should take a lead in setting up and/or chairing such a forum or series of workshops. Several of the responses we received from wholesalers agreed this need for Ofwat guidance or support to progress this. Members feel it unlikely, without a demonstrative and hands-on approach from Ofwat, that little will change in the general approach from wholesalers and the market will, at best, continue to benefit only 20% of the customer base or, at worst decline with more retailers exiting the market, voluntarily or otherwise. This is not the outcome that UKWRC members wish to see nor, we believe from our recent discussions with you and Defra officials, is it your or government's desire.

Our suggestion therefore would be to include all or most of the six responsive wholesalers in such a policy forum or series of workshops. UKWRC members are keen to cooperate and collaborate in contributing and would work with Ofwat and responsive wholesalers to help set this up.

UK WATER RETAILER COUNCIL

We welcomed your recent appearance with Defra at our last Council meeting and your confirmation that we are aligned on the key issues holding the market back. UKWRC members are unanimous that only by working together and reducing the frictions and complexities will we make the market work better and deliver benefits for all NHH customers, whatever their size.

Finally, for completeness, I have attached the text of our letter to wholesaler CEOs, setting out our views on driving improvements to the business retail market as an appendix to this letter.

I look forward to hearing from you and your thoughts on our proposal.

Yours sincerely

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Appendix - Text from UKWRC letter to wholesaler CEOs - dated 13 September 2019

Improving the NHH Competitive Market: Tackling Market Frictions

All market participants have a role to play in achieving the necessary improvements to address market frictions but as highlighted by Ofwat in the State of the Market report issued on 11 July, performance of wholesalers against industry standards and interactions between wholesalers and retailers have had a significant impact on customers' experience of the market.

A lot remains to be done in several areas, but we have identified three key topics which we believe will help drive better service for customers, deliver lower and more equitable bills and inject more innovation to deliver better and more cost-effective outcomes to ensure a resilient business retail sector. These are:

1. Driving Practical and Targeted Harmonisation.
2. Improving Quality of Market Data.
3. Introducing an Effective Wholesale Incentive Framework for NHH Market.

We have set out more detail for each of these areas on the following pages. We recognise that some of the issues are substantial and will take time to resolve, but we are now two and a half years into the market and cannot afford to prolong the 'frictions' that are undermining its effective operation.

1. Driving Practical and Targeted Harmonisation

It is widely recognised that the current market has only a very limited degree of harmonisation with most wholesale regions adopting unique approaches to process requirements around tariff structures, key policies and exchange of Bilateral forms.

We recognise that full harmonisation across the market would likely present the industry with a herculean task, and we have highlighted below a few targeted improvements to the current situation which we believe would provide rapid benefits to our customers and would enable a more efficient market.

Wholesaler Tariffs

One of the biggest issues that impacts NHH customers is the huge variation in wholesalers' pricing structures and the methodologies used by wholesalers to derive their charges. A customer with identical sites in different regions can face very different charges for each site, not because their sites impose different costs on the system, but simply because the wholesalers have made different cost allocation or charging methodology decisions.

Because of these differences, understandably, customers struggle to understand whether they are on the correct tariffs and find it difficult to compare quotes on a like for like basis. The complexity also makes it impossible for retailers to offer customers a unified price across a multi-site or national contract, which is what customers were led to believe would be possible once the market opened. The same is true for customers with separate water and wastewater wholesalers, where the benefit of consolidating their services is undermined if the two wholesalers have different charging approaches.

There are over 11,000 wholesale 'live' tariff elements in CMOS across the market. The sheer scale and complexity of this tariff landscape also causes retailers considerable operational and service problems. The potential for error in processing tariffs is high, and the extent of manual intervention required pushes up cost to serve, both of which have knock-on implications for customers.

As mentioned above, we recognise that full harmonisation of tariff structures across the market is probably not realistic in the short-term. However, we believe that a significant step change can be made in terms of customers' ability to understand and compare their charges as well as market operational efficiency by some or all of the following:

- Aligning on a common set of volumetric bands, which should also be consistent to the price bands set by Ofwat as part of the REC process.
- Agreeing a set of standards for (a) seasonal charging; (b) block charging; and (c) start of the financial year.
- Where meter sizes are used for charging, the size brackets could be aligned across all wholesalers, e.g. < 15mm, < 20mm, etc. rather than these varying from wholesaler to wholesaler.
- Charging consistently for the same services, for example (i) charges for drainage are applied in some areas but not others; (ii) the use of samples in TE charging is inconsistent (some retrospective and some forward looking); and
- Agreeing a common methodology for allocating fixed and variable charges.

The expected reduction in wholesale prices as a result of PR19 gives us an opportunity to manage the potential incidence effects of changing tariff structures with minimum impact of customers. As a first step we suggest an industry workshop with Ofwat is organised to discuss the scope for making these changes and the potential implications.

Wholesaler Policies

The Wholesale Retail Code sets rules on how the market processes work, but because wholesalers are free to set their own rules in relation to many of the policies that are handled through bilateral arrangements, it means that in practice there is a high level of variation between regions.

Key examples include different policies on 'leak' allowances (whether an allowance will be granted for a leak, what period that allowance would cover, and how that allowance is calculated), 'return to sewer' allowances (where the criteria to receive the allowance and the allowance itself vary by wholesalers) and 'data logger policies' (where wholesalers have different policies on whether retailers can install data logger and on provision of data from wholesalers' data loggers to retailers).

Furthermore, there is no consistency in:

- The rules on how each policy works
- SLAs that apply to the process steps (where these are not set by the market codes).
- Charges levied by the wholesalers for carrying out tasks (e.g. site verifications).
- The way in which each wholesaler communicates with retailers.

In combination, these differences significantly complicate the processes involved, meaning that retailers are unable to standardise and automate processes and have a greater reliance on manual intervention. This makes for potentially slower and inconsistent responses to customers and increases the overall cost to the retailer.

We recognise the good work that the RWG had done on the harmonisation of some of the key policies and the production of 'good practice' guides, but unless there is a common commitment to apply them across the whole market, it does not solve the problem.

Bilateral Portal and Processes

There is strong alignment amongst retailers that the introduction of a unified Bilateral solution for communications between retailers and wholesalers in the competitive market is an opportunity for the industry to significantly improve data flow, market operation and customer outcomes.

We are pleased that Ofwat and MOSL have taken a strong lead in making this happen, but there is still considerable scope to influence the size and shape of the solution. We believe that not only is it important to have a single portal, but that the key processes are aligned and standardised, and that the solution provides a common tool for monitoring SLAs.

2. Improving Quality of Market Data

At almost every meeting of the UKWRC, we have discussed the issues around market data and the problems experienced by retailers which continue to drive poor experience and complaints from non-household customers.

We firmly support the on-going work led by MOSL to improve market data, but we believe that a more holistic approach is required to address the extensive data quality issues remaining. As well as establishing the actions required, given that many of the data items were inherited by retailers, there also needs to be agreement over how improvements will be funded. We would expect wholesalers to meet the costs of correcting data provided at market opening.

We acknowledge that there are some good examples of positive initiatives undertaken by individual wholesalers, which demonstrate good practice and which we would like to see adopted more widely. For example, Southern Water undertook an initiative to tackle unread meters, investing ~£50 per meter (£200k in total) to identify and resolve issues associated with 4,000 'not found' meters.

Vacant Charging and Vacant Site Incentive Schemes

The treatment of vacant sites is an example of lack of consistency amongst wholesalers in both policy and charging methodology, that we are particularly worried about.

We recently raised with Ofwat (see attached letter in response to PR19 Draft Determinations) our concern about the ad-hoc and piecemeal development of the bespoke vacant incentives in PR19, the uncertainty about how this will flow through to retailers and the prospect that some wholesalers may introduce or extend charging for vacant properties in 2020 in response to the PR19 incentives.

Retailers are keen to work with the wholesalers, Ofwat and MOSL, to understand the real issues behind vacancy and to develop a uniform, market-wide solution that addresses the causes. This might be a vacant site incentive scheme, but it needs to be applied consistently across the market and avoid the pitfalls of the schemes that were put in place in Scotland.

In the meantime, we have proposed that the vacant charging options in CMOS are suspended and a halt is put on the piecemeal development of downstream incentive schemes. It might mean that the PR19 incentives around vacant are also suspended for a period, to allow sufficient time for the development of a common solution, and to align the performance incentives.

Meter Reading

The capacity of independent meter readers and the availability, cost and quality of their reads is a frustration for retailers in the NHH market. The cost and quality of cyclic reads from wholesalers has generally improved, but availability is not uniform, and terms and conditions of provision vary between regions.

In some areas wholesaler reads may exist, or wholesalers have metering technology that could be remotely accessed by third parties. We would be interested to understand how retailers could gain access to these additional reads and/or technology and to discuss the capacity and cost issues more generally.

We would also make a plea on behalf of NHH customers that they be included in wholesaler smart meter programmes or meter exchange programmes. This could go a long way towards improving the availability and quality of meter reads in the NHH market as well as driving water efficiency.

3. Introducing an Effective Wholesale Incentive Framework for NHH Market

We note that more than two and a half years since the market opened, and apart from the OPS framework, there is no effective wholesaler incentive mechanism in place in relation to the non-household market, nor is there a committed timeline to develop one.

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 wholesalers' performance at both the customer (i.e. end-user) and retailer level, and we have set out below in more detail the two pillars of such an 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 for the NHH market, and we are proposing that a B-Mex is introduced to cover the services provided by wholesalers to retail customers. The B-Mex could address for non-household customers similar areas covered by C-Mex for the household market. This scheme could be made of a mix between customer surveys and performance metrics on key areas, and 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:** 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. 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. We would be happy to work with wholesalers ahead of the Final Determinations to develop a target measure for business customers, which could be applied to a relevant proportion (20-25%) of the incentive fund already set aside for water efficiency.

- **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 we have highlighted to Ofwat the need for wholesalers' Business Plans to 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.

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 19) and we would be happy to engage further with Ofwat and wholesalers to explore this further.

Retailer Measure of Experience or 'R-Mex'

Monitoring 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. 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 have invited Ofwat and MOSL to play a more active role in coordinating with wholesalers and retailers the implementation of such a measure (given that there is no direct financial impact on wholesalers, it could easily be implemented outside the PR19 process).

I hope that this gives you an indication of the issues that we would like to see addressed in wholesalers NHH Market Plans. As mentioned above, retailers are very keen to work with the wholesaler community to develop robust, common pricing and policy frameworks and practical working solutions that will make the market work more effectively.