

## Ofwat consultation on the PR24 Draft Methodology

### Response summary

We welcome the opportunity to comment on Ofwat's PR24 Draft Methodology and are pleased to see the non-household market better included in the proposed Performance Commitments (PCs). There are several areas we wish to provide feedback on: Ofwat's suggested market challenges, the proposed demand reduction PCs, wholesaler-retailer collaboration, and BR-MeX.

We do feel that further precedence could be given to how NHH customers can contribute to demand management, particularly in light of the proposed Defra targets, and feel there are many innovations from wholesalers and retailers which could support this. For example, innovative tariff structures which incentivise water efficiency and sustainable drainage. There is an opportunity to use tariffs to encourage customers to invest in changes to their site which may have a significant impact on sewer flooding, for example.

When discussing market challenges, we would like to see how these affect the household and non-household (NHH) markets clearly distinguished. The NHH market has already received less investment for solving climate and demand management challenges and has not yet delivered the level of water efficiency predicted at market opening. The drive to stabilise or reduce bills despite an increasing need for investment is harming the NHH market's ability to increase water efficiency and reduce demand, as well as meet customers' increasing needs and expectations.

The lack of metering and metering technology is an additional challenge facing the NHH market, which should be addressed within PR24. A cohesive national approach to metering is needed to improve customer outcomes, enable better demand management, and provide a consistent level of service between regions. The Strategic Metering Review's work is excellent, but the power to drive forward a strategy lies with Ofwat and wholesalers, who currently have varying appetites for investing in metering improvements, despite the far-reaching benefits. There is also a risk that SME customers could be disadvantaged if wholesalers focus on perceived quick demand reduction wins with high consuming larger businesses.

We recognise the introduction of the PC is in response to urgent water resource challenges but it's important to get the design right and avoid undermining the future of competition. A collaborative approach between wholesalers and retailers to delivering water efficiency is essential to avoid undermining the competitive NHH retail and water efficiency services market. Below, we share examples of collaboration opportunities and schemes we have engaged with and suggest how these could be improved.

Finally, we welcome the inclusion of financial incentives for good NHH service through BR-MeX, and broadly support its introduction. Good design is again essential to ensure a balance between serving customers and retailers.

We thank Ofwat for the opportunity to comment on the Draft Methodology and would be happy to discuss our response in more detail directly.

We look forward to seeing the results of this consultation in due course.

### Consultation questions

**Q2.1: Do you agree with the challenges facing the sector and the ambitions for PR24 we have identified?**

- i. Combating climate change, protecting the environment, and sustainable management of natural resources*
- ii. Customer expectations about what companies need to deliver*
- iii. The need for affordable bills.*

We agree with the stated challenges facing the industry and Ofwat's proposed building blocks. However, while NHH consumption is often equivalent to domestic customers', business customers have significantly different needs, priorities, and expectations.

There must be balance between affordability and other challenges facing the sector. The investment challenges that the industry faces over the next 25 years are significant, and concerns around customers' ability to pay must be balanced against the urgency to invest in environmental issues such as sewer flooding, river quality and water scarcity. The consequences of under-investment in these areas will be considerably more detrimental to NHH customers in the near future than marginal, justified bill increases implemented now.

Low investment in asset maintenance and repair frequently triggers billing and service issues, the greatest cause of customer dissatisfaction in the non-household market. In addition, the level of investment required to tackle climate resilience and demand challenges is significantly above what is currently available. The NHH market has already fallen behind in addressing these challenges and we must catch up.

A key output which would enable water companies and customers to meet all the market's challenges is improving metering and the technologies used to measure and report customers' usage. We appreciate the focus on outcomes through PR24. However, a national metering strategy is a core output required to address the challenges facing the sector. This is because:

- i. Smart metering enables timely, granular data to be collected from NHH properties, which can be used to identify leaks and wasted water and better forecast demand (e.g. by time of day, season, weekday etc), which supports demand management. All wholesalers could perform better on leakage reduction with a smart meter rollout, supported by retailers.*
- ii. Customers expect good service, which includes timely, accurate bills, support with leaks and supply issues, and functional and well-maintained meters. They often also expect suppliers to provide smart metering free of charge, as in the energy industry. Customers are also beginning to express greater concern about environmental issues and expecting companies to do better at tackling these. However, customers frequently do not understand the link between their own consumption and issues like water scarcity, environmental degradation, wastewater management or carbon emissions. Nor do they have an accurate understanding of their own consumption. Not only is smart metering beneficial to water companies, but it can help customers understand the link between their usage and their bills, as well as make bills more accurate.*
- iii. Customers naturally want to keep bills low. We do not expect customers to volunteer to pay more, but much of the customer research at PR19 demonstrated the trade-offs that many customers were willing to make in order to improve their services and the environment. As water companies battle increasing environmental, resilience and demand challenges, bills will need to increase.*

Smart metering enables customers to play their part in tackling these challenges by better understanding how they can reduce their usage and seeing the environmental and cost benefits of using water more efficiently

Improving non-household metering is a key enabler for water efficiency initiatives because it ensures that their effectiveness can be properly evaluated and help customers to engage with the behavioural requirements of reducing consumption. But there are many other benefits, as demonstrated by Artesia Consulting's report on the business case for enhanced metering technology earlier this year.

Many trading parties have expressed concern about the inadequate performance of metering assets and meter reading processes to deliver cost efficient and robust services in the market. Metering has been identified as a root cause of several issues in the market, leading to poorer customer service, inaccurate bills and limited uptake of water efficiency offers. Despite this, few wholesalers have significantly committed to smart meter rollouts. Some already have active programmes which they intend to continue through AMP8, while others still do not consider smart metering to be a priority. We are concerned, as a national retailer, that we will ultimately end up with regional markets for smart metering, rather than one national one, if wholesalers are allowed to choose whether it's a priority for them. We wouldn't like to reach the end of AMP8 and still see traditional meters being installed with a 10+ year asset life, nor for SMEs to receive a lower level of service than larger users.

While there is excellent work being carried out by the market based Strategic Metering Review teams, they do not have sufficient power to make the necessary changes to metering strategy and practice in the market. The power to make these decisions lies with Ofwat and the wholesalers.

Metering isn't directly addressed anywhere in Ofwat's Draft Methodology for PR24, but it is a vital output to enable market ambitions to be achieved - regardless of who is incentivised to deliver it. MOSL's Strategic Metering Review report concludes that there is a clear long-term cost-benefit case for smart metering, and options for clarifying and optimising roles/responsibilities are currently being explored.

We would like to see smart metering ambition further explored once companies have released their draft Water Resource Management Plans and Drainage and Wastewater Management Plans later this year.

## **Chapter 5 – Delivering outcomes for customers - Performance Commitments (PCs)**

**Q5.1. Do you agree with our proposed package of common Performance Commitments? Is water demand best incentivised through separate PCs on business and household consumption and leakage, or through a PC measuring total demand?**

We support the inclusion of a NHH PC around water demand. NHH customers represent 30% of total consumption and there is plenty of opportunity to encourage water efficiency. The main blockers to driving water efficiency in the market so far have been funding, confusion around roles and responsibilities, and low demand from customers. A PC placed on this makes roles and responsibilities clear and provides a mechanism for funding, which in turn could unlock customer demand.

We broadly support a combined PC including business and household consumption and leakage reduction. In combination with Defra's proposed demand reduction targets and separate reporting of these, there is no need for further separate targets because companies

will be held accountable for all three commitments. Separate PCs for each may cause companies to continue to prioritise household projects over NHH, because so much work has already begun in this market.

However, a **collaborative approach** between retailers and wholesalers to address NHH demand reduction is essential, regardless of how PCs are structured.

Reports currently emerging in the market suggest that due to low customer demand, and the large amount of regulatory change required to re-align funding, a wholesaler-led approach is the most likely path forward. We've already expressed concerns about how wholesaler-led water efficiency schemes could impact competition in water efficiency services and retail competition if not appropriately designed; conversely, by working collaboratively with wholesalers in the right way, we are confident that we can drive value for customers and the environment.

The commercial arrangements of such collaborations should be thoroughly explored to ensure they are fit for purpose. Retailers can still add value through generating demand, the use of benchmarking and alerting services and coordinating the delivery of projects. Based on previous experience of collaborating with wholesalers on the delivery of water efficiency projects, we have many ideas on how collaboration can be done best, and are happy to provide further feedback to Ofwat if desired.

We would also support the disallowing of outperformance payments where wholesalers cannot demonstrate they have adequately explored collaboration with retailers.

- ***Appendix 6 – Performance Commitments - Customers receiving excellent service every day***

**Q6.3: What are your views on our proposal to introduce a single, combined common Performance Commitment ('BR-MeX') capturing the experience of both end business customers and retailers as intermediate customers?**

We welcome the addition of a financial incentive for wholesalers to serve retailers (and, by proxy, business customers) well. However, if a combined common PC is introduced, it must be carefully designed. For companies to be measured on relative performance, all companies must already be meeting a minimum standard to produce an acceptable median from which to measure over or under performance. If all companies are sub-standard, then relative performance is simply not enough.

There will need to be careful coordination between the design of this PC and the revised Market Performance Framework (MPF) which MOSL is working on, which will also incentivise wholesalers to perform well on a more transactional basis in and/or in specific areas which benefit non-household customers. Done well, wholesalers performing well at operational and transactional performance standards under the MPF should naturally expect to perform well at BR-MeX, as they will naturally be serving retailers well. It is essential that incentives for BR-MeX are financially significant for all parties and drive outcomes but should not be double counted between the two mechanisms.

There are several risks we would like to highlight and see addressed in the overall design of BR-MeX:

- There are some areas where business customers are directly served by the wholesaler, like water quality. It doesn't matter how many successful bilateral transactions a wholesaler has completed if the quality of water delivered to customers is poor. However, the design of BR-MeX must not lead to customer confusion about who serves them directly. For this reason, we would support a collaborative approach to BR-MeX delivery with retailer led customer communications.
- It's also vital to ensure that BR-MeX proportionately represents how wholesalers serve customers, and how they serve retailers. This should be broadly equal. If the scoring from customers holds greater weight than from retailers, then wholesalers will naturally chase good results from the customer and place more of their efforts there, rather than ensuring a good relationship with the retailer (or vice versa).
- There's an additional risk that too few retailers may lead to one (e.g., the associated) retailer's score holding disproportionately higher weight for their associated wholesaler. When wholesalers and retailers belong to the same corporate group, it may be in their interests to score too generously to increase financial incentives. We hope that all wholesalers and retailers are committed to doing the right thing and that this does not become an issue.

## Next steps

We thank Ofwat for the opportunity to comment on the Draft Methodology and would be happy to discuss our response in more detail directly.

We look forward to seeing the results of this consultation in due course.