

## MOSL's response to Ofwat's draft methodology for PR24

### Introduction

As the market operator for the non-household (NHH) water market in England, MOSL welcomes the opportunity to respond to Ofwat's draft methodology for PR24.

Due to the timing of the opening of the NHH market, PR24 is, effectively, the first price review for the needs of the market to be included.

PR24 is, therefore, an important opportunity to use the lessons of the past five years to deliver a step change to ensure a sustainable, flourishing market that delivers for trading parties, customers and the environment.

This year's drought has reinforced the important role the NHH market – which consumes 30% of the country's water – can play in reducing water consumption. Enhanced metering has the potential to transform efforts to increase water efficiency and improve data quality and should be at the forefront of this challenge.

Independent research concluded that there is a strong business case for investing in enhanced metering, recommending that companies with large-scale plans to roll out smart meters for household customers should include NHH customers at the same time, while large NHH customers and those in close proximity would also benefit from having their meters upgraded or replaced.

The primary source of funding for enhanced metering is the Price Review process. However, the investment could be funded through efficiency savings (e.g., in the cost of visiting and reading meters). We note the absence of any clear direction from Ofwat on enhanced metering in the methodology and urge that it is not assumed that customers prefer not to have meters or that the investment would lead to increased bills.

Whilst Ofwat is recommending that larger NHH customers are omitted from the NHH demand reduction target, we are keen to explore how larger NHH customers can be encouraged or incentivised to use water more sustainably, whether by using water at periods of lower demand (akin to the 'Triad' electricity tariffs), harvesting rainwater or recycling grey water. These initiatives should complement a continuous drive for these customers to use less water, where economically viable.

At the other end of the scale, 80% of NHH customers use approximately the same amount, or less, water than households and for the same purposes. We believe these business customers should share the same water reduction target and receive the same water efficiency communications and support as households. We do not believe that adopting a different approach would be as effective in encouraging water savings.

The current regulatory framework is weighted heavily towards households. PR24 is an opportunity to address this imbalance and put in place the right incentives at the right scale to ensure the needs of the NHH market are considered in wholesalers' business plans and Board rooms.

Ofwat's focus has been on three key market frictions to date: the quality of market data, the management of retailer-wholesaler (bilateral) transactions and wholesaler performance.

We have been pleased to work with Ofwat on these issues and to have made considerable progress. However, our view – supported by the market health report last year – is that the market still has fundamental issues which won't be solved by tackling market frictions alone, for example, retailer margins.

MOSL's understanding is that retailer margins will be addressed as part of the Retail Exit Code (REC) Review. If this is not the case, Ofwat will need to consider how PR24 could be used to provide the financial headroom retailers need to ensure they can continue to deliver for NHH customers and the environment.

Overall, while there are a number of positives for the NHH market in the draft methodology, we remain concerned that the PR24 process is not yet giving sufficient priority to increasing wholesalers' focus on the NHH market and improving outcomes for its customers.

**MOSL's three key messages to Ofwat are:**

1. MOSL believes more work is needed to establish the business case for BR-MeX, evidence the value it could deliver to the market compared to using separate metrics and how we can increase SME engagement with the market generally
2. MOSL recommends developing an enhanced metering strategy that encompasses both household and NHH customers and takes into account the benefits from a national, rather than regional, perspective (e.g., improvements in data quality, the benefits of a more detailed picture of customers' water consumption, identification of leakage, etc.)
3. We welcome the proposal to include business demand reductions in the proposed performance commitments for the first time. The final methodology must ensure an appropriate focus on reducing both non-household and household demand. If the largest non-household customers are excluded from this metric (as proposed), it must still include a targeted incentive for customers to reduce their demand or move to more sustainable water usage. Where the majority of NHH customers are using water for domestic purposes, we can't see a logic for a different target from household customers.

If you have any questions on our response to this consultation, please email [comms@mosl.co.uk](mailto:comms@mosl.co.uk).

## Answers to questions and views on specific areas

### BR-MeX

QA6.3. 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?

- ◆ **MOSL believes more work is needed to establish the business case for BR-MeX and evidence of the value it could deliver to the market as well as the costs involved. This will need to consider the resources required for MOSL to support the design and administration of it, how it aligns with business customer preferences and their willingness to pay and how to increase overall engagement with the NHH market.**
- ◆ MOSL agrees there is a need for measures to incentivise stronger wholesaler focus and performance in the NHH market. However, we are concerned about the levels of complexity and costs that could be involved in capturing the experience of business customers given their low levels of awareness of the respective roles of retailers and wholesalers. Ofwat's [State of the Market Report 2020-21](#) highlighted this issue with 53% of SMEs aware of the market and their ability to switch retailer.
- ◆ The success of the metric will heavily depend on the finer details of how it is designed. **We believe more work is needed to clearly explain and evidence how the incentives across household (HH) customers (through C-MeX) and NHH customers (through BR-MeX) are comparable.** This is a complex area and we do not believe it is clear in the draft methodology. There is a risk stakeholders will find it difficult to understand whether the penalties provide a fair and equal relative importance across HH and NHH customers.
- ◆ **We agree BR-MeX could fit better in PR24 than a reformed MPF** – but if BR-MeX is taken forward, Ofwat will need to ensure BR-MeX is designed to be able to respond to the reformed MPF as it is developed. One of the objectives of the reformed MPF is that it is agile to market change - which the measure of experience mechanisms in the price control are not designed to be.
- ◆ **If the BR-MeX incentive is included in the final methodology, appropriate funding will be needed for MOSL to support the design and administer the pilot and the final BR-MeX incentive.** Ofwat needs to work closely with MOSL to understand what may need to be built into our next business plan for 2023-26 which we have started developing. This will need to be added at a time where there are significant wider economic pressures on market participants. We expect these costs to be ongoing and, along with other MOSL charges, would expect it to be included as part of Retail Exit Code (REC) review.
- ◆ We believe the proposed sources of evidence (business customer survey, R-MeX survey and potentially feedback from the bilateral transactions hub) seem reasonable but more work will be required to properly

flesh out how we use data, and the interaction with the reformed MPF. For example, it will be important to ensure the data in CMOS is of sufficient quality to underpin BR-MeX which could be driven by a future MPF.

- ◆ We are aware of concerns around associated retailers under shared ownership with wholesalers where retailers would be effectively scoring their own wholesaler. BR-MeX would need to ensure there is no bias or perception of bias.
- ◆ For the R-Mex element, there will be a need to consider the timing of surveys and the frequency. This could be once per year to enable wholesalers time to drive real change. There is also a need to consider what timing would give retailers the best opportunity to give responses the right level of time and attention in light of competing market priorities.
- ◆ We have also received feedback from trading parties that it is important the positives of the current R-MeX design, e.g., qualitative, granular feedback are not lost and that BR-MeX balances quantitative data with the qualitative data currently captured by R-Mex.

## Enhanced metering

- ◆ **A national longer term enhanced metering strategy should be considered** – including technology, data and interoperability standards. This would not be prescribing mandatory volumes of meters for PR24 but would set a clear long-term direction of travel which, leaving wholesalers to just look at own regions does not. MOSL believes Ofwat could commit to this in the final methodology without further central government policy or direction, with the demand reduction targets that Defra is expected to put into force later this year a sufficient driver.
- ◆ **A wider vision from Ofwat around metering that goes beyond just the potential outcomes in terms of demand reduction would bring significant benefits to the NHH market.** Enhanced metering can be a key enabler for NHH to play a major role in reducing demand – but also represents a big opportunity to unlock ‘value’ in the market and invigorate competition to give NHH customers greater ‘choice’. It can help deliver timely, accurate national consumption data and provide retailers with a real tool to differentiate and to develop innovative water efficiency offerings, one of the policy objectives of opening the market. It will also be key to achieving the 9% demand reduction target for NHHs that Defra consulted on in the summer.
- ◆ Enhanced metering also provides a major opportunity to reduce the meter reading cost to serve but with retailers operating across wholesaler regions, a fragmented approach to metering will hinder the ability to drive down these costs.

- ◆ As part of the [Strategic Metering Review](#), MOSL and the Metering Committee have published a report recently on [enhanced metering technology](#) which shows the clear business case for rolling out enhanced metering for NHH customers in PR24. It also highlights the benefits that can be achieved by a national focus on the larger meters in the market (i.e., those larger than typical household meters), enhanced metering technology principles and a national governance approach.
- ◆ Work is underway on reassessing the [roles and responsibilities](#) for NHH metering with a recent report and recommendations by PA consulting. Work is also starting on potential common data standards to ensure interoperability. We are keen to work with Ofwat to ensure solutions that could unlock value around enhanced metering are not locked out until PR29, which could be too late for the necessary demand savings to secure future supplies and protect our natural environment.
- ◆ **In the absence of a national strategy, the sharing of learning from wholesalers who are already deploying NHH smart metering will be key to drive implementation across regions.** We are aware of wholesalers who are keen to roll out enhanced metering for NHH customers in PR24 but due to a lack of rollouts in their areas to date, need evidence to support their business cases.
- ◆ MOSL believes there is a serious risk that enhanced metering strategies (for households and NHHs) from wholesalers will not come forward due to competing priorities such as water quality. This creates the risk that wholesalers will be installing traditional ‘dumb’ meters at the end of PR24 with asset lives out to 2045.

## Water efficiency

Q5.1. Do you agree with our proposed package of common performance commitments? Is water demand best incentivised through separate performance commitments on household and domestic consumption and leakage or through a performance commitment measuring total demand?

- ◆ **MOSL strongly welcomes the proposal to include business demand reductions in the proposed performance commitments** for the first time as the previous focus on per capita consumption (PCC) excluded the 30% of water consumed by NHH customers.
- ◆ The market, which has one central repository of data for all this water represents a huge opportunity to manage water demand, increase efficiency, and play a part in delivering net zero, but to do this will require a different, more ambitious strategy on enhanced metering.

- ◆ **The final methodology must ensure appropriate focus on reducing non-household and household demand.** We are concerned the proposed targets put forward by Defra earlier this year will drive an unequal focus by water companies towards reducing household over non-household consumption as a result of the uneven reduction targets – 9% reductions for NHH customers by 2037 being around half of the proposed target for households. This is particularly important because nearly 80% of NHH customers use the same or less than a typical household, and 90% use water for domestic purposes so will need the same or similar interventions as households to help them use less water.
- ◆ **There must be an incentive on the largest customers to reduce their demand or switch to a more sustainable source** - even if they aren't included in the wider metric – because they account for a vast quantity of water that could potentially be saved or used in a different way. Not placing any obligations on them at all could drive perverse behaviours where opportunities for significant demand reductions are not prioritised over more costly interventions for smaller businesses or households. The incentives for the largest customers must be tailored to their needs and allow for innovation in areas like greywater recycling to avoid the unnecessary use of drinking quality water.
- ◆ MOSL agrees with Ofwat on the importance of wholesaler and retailer collaboration to help NHH customers use water more efficiently. There is a need, as part of the final determination for Ofwat to:
  - Provide a framework for what that collaboration should or should not look like
  - Clarify the implications if certain things don't happen in relation to the proposal to disallow outperformance payments if wholesalers can't demonstrate they have explored options to deliver NHH water efficiency
  - Provide firmer reassurance to wholesalers around the Competition Act and how it should not be a barrier to collaboration
- ◆ MOSL is supportive of a national framework that sets out the baseline expectations for collaboration but still allows for innovation in areas where wholesalers and retailers agree on approaches to go beyond the minimum framework
- ◆ As with BR-MeX, it will be crucial to ensure that the incentives around demand reduction in PR24 are designed to align with the behaviours being driven through the reformed MPF. There are examples at the moment where there are vacant sites that potentially have a leak on the customer side, yet wholesalers are currently not incentivised to fix it under the current MPF.