



STRATEGIC
PANEL
& Committees

The Strategic Panel's response to Ofwat's consultation on the draft methodology for PR24

Introduction

The [Strategic Panel](#) ('the Panel') welcomes the opportunity to provide feedback on Ofwat's draft methodology for PR24. The Strategic Panel is the most senior industry group in the non-household water market and comprises members drawn from market participants and independents including Defra, Ofwat and CCW¹. The Panel's role is to promote, challenge, and lead the operation and evolution of the market for the benefit of current and future non-household (NHH) customers.

The Strategic Panel believes fundamental change to the non-household water market is needed if we are to secure the best outcomes for customers and the environment. Ofwat, as the architect of the market and in line with its duty to promote competition, has a critical role to play in addressing the structural problems. We are concerned there is insufficient focus on the NHH market in PR24, including the cost and complexity of operating within it and the structural changes that may be required to fix it in areas such as metering and data quality – which remain fundamental issues.

The Panel recognises that the sector more widely is under significant pressure with climate change, population growth, growing regulatory requirements, and escalating customer expectations creating challenges in relation to service improvement, investment, and affordability. We consider that the retail market and the actions of the NHH customers it serves has an important part to play in addressing these challenges. We would encourage Ofwat to look more holistically at the role of the non-household market as part of a whole systems approach. Whilst the non-household market accounts for 30% of the water consumed in England, it also accounts for 100% of trade effluent. Focus should not just be on reducing water consumption but on innovations around grey water usage, total catchments management solutions, and sustainable drainage. We urge Ofwat to be explicit on the importance of the NHH market in building resilience across the wider sector.

Metering, for example, can support the industry in better managing supply/demand challenges through better availability and use of consumption data. It is important to recognise that a 'one size fits all' approach does not work for customers. Domestic customers do not have the same considerations as NHH customers, who may want to make informed decisions around investing in smarter metering to reduce their usage and overall costs. The lack of visibility or coordination of water companies' metering plans will make these investment decisions more difficult, particularly for larger business customers, who could play a significant role in reducing the demand on our water supplies through having more granular consumption data.

The market challenges are outlined in the Panel's recently published [Priority Market Outcomes document](#). As part of the consultation on the draft priority outcomes this summer, there was broad support for the Strategic Panel's position on the fundamental changes needed now that we are five years into the market.

¹ Ofwat and DEFRA representatives did not take part in the Panel's consideration of this response.

The Strategic Panel said setting appropriate wholesale revenues, to fund the outcomes the NHH market needs, and setting appropriate incentives to drive delivery were essential outcomes of PR24. The table below outlines the priority areas and the extent to which the Panel believes they are covered by the draft methodology for PR24:

Priority Areas of Work	Description	What is covered in PR24 draft methodology
Get the money right	Create a commercial framework in which efficient and successful market participants make appropriate risk adjusted returns or better by; earning a fair and sustainable return on their investments; and delivering services that demonstrate value for the customer.	<ul style="list-style-type: none"> • Ensuring retail margins are sufficient to allow all customers to participate in the market and efficient retailers can earn a fair return will need to be addressed through the Retail Exit Code (REC) review. • The scale and nature of metering investment by wholesalers could (where appropriately prioritised) also reduce retail costs in the market increasing margins and providing better service to customers through more accurate bills (see page 8 'Enhanced metering'). • The approach and incentives under PR24 for wholesalers could impact on the level of overall margin in the market, in particular: <ul style="list-style-type: none"> ○ Improving wholesaler performance against the proposed BR-MeX (business customer measure of experience) incentive could reduce market frictions reducing retail costs. ○ Incentives for wholesalers to encourage reductions in demand amongst NHH customers could create new opportunities to encourage water efficiency.
Get the basics right	Customer bills and market settlement is based on accurate consumption data and there is improved access to data to promote innovation.	<ul style="list-style-type: none"> • The proposed new BR-MeX incentive could help to drive improvements in the delivery of core wholesale services to retailers and NHH customers. • The approach and outcomes adopted by wholesalers in relation to metering and

	<p>Align retailer, wholesaler and market operator processes to improve efficiency and customer value, while recognising that appropriate variation may be in the customer interest.</p> <p>Get the basics right in customer interactions and communications.</p> <p>Create a flexible and responsive code change mechanism that prioritises the right outcomes.</p>	<p>enhanced metering investment will be critical in supporting improved data quality.</p>
Water efficiency	<p>Market participants and customers are incentivised to use water efficiently.</p> <p>The market enables customer understanding of consumption and treats water efficiency as core business.</p>	<ul style="list-style-type: none"> • New performance commitment or commitments covering NHH demand could increase incentives to reduce NHH demand and create new opportunities to drive water efficiency. • The approach and outcomes adopted by wholesalers in relation to metering and enhanced metering investment will be critical in supporting water efficiency.
Get the incentives right	<p>Align market participant incentives to drive customer, social and environmental benefits and value.</p>	<ul style="list-style-type: none"> • A correctly calibrated BR-MeX incentive could help drive greater value for customers.
Innovation	<p>Create the right market mechanisms to create new value, making the market genuinely attractive to new entrants and new business models, delivering organic innovation, new customer propositions and environmental benefit.</p>	<ul style="list-style-type: none"> • The proposed continuation of the innovation fund into AMP 8 provides an opportunity for market participants to collaborate with partners to address shared challenges in the sector, for instance around increasing water scarcity, reducing environmental harm, or achieving net zero.

As outlined in the table above, there are positives for the NHH market in the draft methodology in terms of delivering against the priority market outcomes – like the proposal for more high-powered incentives on wholesalers to support retailers and NHH customers and the inclusion of NHH demand reductions in a performance commitment for the first time. While the proposed changes have the potential to drive improved market, environmental and customer outcomes, more work is needed in advance of the final methodology. We have set out in our response both where we consider that work is needed and how we could support Ofwat through that work.

The Strategic Panel's three key messages to Ofwat are:

1. We welcome the proposed BR-MeX performance commitment; we consider that the current incentives under the Market Performance Framework (MPF) are not as effective as they could be in driving wholesale focus on the market and NHH customers in it, but the detail needs to be worked through to ensure:
 - 1) the incentive strength is calibrated correctly to have the appropriate power to drive improvements and be consistent with NHH customer preferences and willingness to pay
 - 2) it drives the right outcomes and operates consistently and effectively with the reforms we are making to the MPF
 - 3) other means for complementary quantitative measures of service are considered to drive high quality and consistency in performance across wholesalers.
2. A national longer term enhanced metering strategy should be considered – on roll outs, technologies, data and interoperability standards. This would not be prescribing mandatory volumes of meters, but would recognise the wider benefits e.g. data quality that leaving wholesalers to just look at their own region may not.
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 non-household and household demand, particularly given the significant water scarcity challenges we have as a nation. We would encourage Ofwat to ensure metering, the market, and the role of NHH customers are sufficiently prominent in its thinking in setting the direction for water companies' in achieving demand reduction targets. This is essential for Ofwat to deliver its objective (as set by Defra in its Strategic Policy Statement) to “work with the water retailers, incumbent water companies and other stakeholders to support and contribute to the delivery of the Industry Action Plan to improve the water efficiency of businesses, in a way that is consistent with its duties.”

Over the next few months, the Panel will define the metrics against which its delivery will be judged. To enable these outcomes to be delivered for customers and the environment, the market needs to be funded and delivered through PR24 (for wholesalers) and the REC Review (for retailers), as well as the MPF Reform and ongoing work to fix the basics. It is crucial to consider how the different mechanisms will work together to

drive these improved outcomes. We are keen to work with Ofwat in ensuring the mechanisms provide complementary incentives to drive performance, and that the strength of these incentives is appropriately calibrated, factoring in customer insight and their willingness to pay.

The Strategic Panel is clear that it will be for the REC review, rather than PR24 to address areas relating to retailer margins going forward. The Strategic Panel believes it will be important for Ofwat to balance effective protection and fair prices for new and existing customers, while enabling efficient retailers to compete on a sustainable basis and so that all groups of current and future customers can benefit from a flourishing competitive market. This is a key strategic priority for the market and getting this right underpins all the other priorities.

Whilst there are a number of helpful changes proposed in the PR24 methodology consultation that we support and would like to work with Ofwat on further, we strongly believe there is a need for Ofwat to review the overall retail margins to 'get the money right' through the Retail Exit Code (REC) review. We look forward to providing our views on the proposals as part of the consultation which is underway. This work represents a much more fundamental challenge to the effective operation of the market.

Answers to questions and views on specific areas

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?

The Strategic Panel welcomes the principle of the proposed BR-MeX performance commitment, as it has the potential to increase wholesalers' focus on retailers and NHH customers and outcomes. However, the detail needs to be worked through to ensure the incentive strength is calibrated correctly and evidenced against how it will deliver improved outcomes for NHH customers, as well as their willingness to pay. We would like to work with market participants to support Ofwat in this work ahead of the final methodology in December 2022.

Retailers operating in the market, and the NHH customers they serve, must take wholesale services from their local regional monopoly company. The absence of any choice or competition means that it is right that wholesalers are incentivised through regulation to improve the service they provide to both groups. This is currently incentivised principally through the MPF arrangements and there are also some early reputational benchmarks through published R-MeX (retailer measure of experience) tables.

The Panel agrees with Ofwat that the current MPF incentives are not operating as effectively as they could be to drive the best outcomes for NHH customers and the retailers that serve them. They also show diminishing returns. We therefore welcome the proposal to increase the strength of these financial incentives and make them higher powered.

We also support these incentives being introduced into the price review rather than only through the MPF. Wholesalers are regulated monopolies providing services right across the water and wastewater value chain. As the NHH retail market represents a relatively small part of their business, they will naturally place a greater focus on Ofwat than the market operator. Introducing these incentives through PR24 will also enable stronger reputational incentives to be introduced.

During the 2025-30 period we would like to see Ofwat publishing, as part of its annual service and performance reporting, a league table of wholesale performance on BR-MeX, as we know that these league tables can command significant management attention in wholesalers and have proved to be a powerful reputational incentive in the energy sector. Introducing these incentives through PR24 also allows Ofwat to consider the overall risk and return balance on wholesalers in line with its statutory duty to ensure these companies are 'financeable'.

The Panel considers that further work is needed to define, improve, and test the BR-MeX incentive ahead of PR24 to ensure that it is as effective as possible:

- We welcome, in principle, the focus of the incentive on outcomes through surveying customers and retailers. The basic design is consistent with the 'C-MeX' incentive and its predecessor the 'Service Incentive Mechanism' (SIM) both of which appear to have been effective incentives for driving service improvement in wholesalers. This approach will need to work in harmony with the changes we are making with market participants to the MPF - which is generally not focused on outcomes but outputs and inputs - if the two incentives are to operate effectively and avoid issues of overlap or double jeopardy for wholesalers. Without visibility of the financial impact within the MPF, it is also difficult to assess the relative strength of the proposed BR-MeX, and we would like to work closely with Ofwat as both workstreams progress so that both incentives complement each other financially as well as practically. We would also like to work with Ofwat to understand whether BR-MeX should also consider quantitative measures to drive improved performance. As proposed, the incentive could result in bill increases for NHH customers under some contexts where wholesalers deliver better services. These services are arguably 'the basics', there may not be a strong case and NHH customers may support a 'penalty only' incentive. We would like to work with Ofwat and market participants to understand how much and to what extent NHH customers value these improvements to ensure that the incentives are calibrated to their preferences and willingness to pay.

- Under the current proposals, the incentive would generate a reward or penalty that would effectively be recycled with a two-year in-period lag in NHH customer wholesale charges. This would drive relatively small changes to NHH customer bills based on wholesaler service performance. Many of the problems we see in the NHH retail market are still not being addressed due to a lack of resources and focus. Funding is also still a barrier to progress. In other markets, like the Scottish retail market, funding sources have been generated from similar wholesaler performance incentives and are recycled to create large central programmes to support initiatives, like data quality improvement across the market. We would like to work with Ofwat in the context of the MPF reform we are undertaking and direct research with customers and market participants to explore the best way to apply and use any rewards and penalties generated by these incentives to maximise the impact on NHH customers.
- Ofwat is proposing to calculate the BR-MeX score using MOSL performance data. We believe that there is scope in this process to include complementary input from the customer perspective in the assessment of performance, and to review how this is done in other regulated sectors.
- Finally, any new incentive needs to be subject to detailed design and testing and there are some practical matters that need to be further developed so that the incentive can be introduced effectively in April 2025. MOSL has already undertaken significant work and thinking to develop the current R-MeX arrangements, and we would welcome the opportunity to work with Ofwat and support work in the detailed design and testing of the new proposals.

The Panel would like to continue to work closely with Ofwat and MOSL as the proposed administrator of the BR-MeX scheme as any funding would need to be factored into their business plan for 2023-26, which will be published at the start of 2023. Equally, it is crucial the two parties continue to collaborate as the new MPF framework is developed.

Enhanced metering

The Strategic Panel is disappointed that PR24 is largely silent on the importance of metering, particularly in the context of the role metering can play in driving water efficiency and ensuring all customers receive accurate bills based on actual consumption. We believe enhanced metering is a pre-requisite for reducing water demand, which is particularly important considering the recent drought events we have seen across the country. The NHH market accounts for approximately 30% of the total water used in England and, in the current economic and environmental climate, business customers will be looking at ways to reduce their bills. These customers, therefore, can play a significant role in reducing demand on our water supplies, but cannot make water savings without firstly understanding their water usage.

A national longer term enhanced metering strategy should be considered – on roll outs, technologies and, critically, interoperability standards. This would not be prescribing mandatory volumes of meters – but

would recognise the wider benefits e.g. data quality that leaving wholesalers to just look at their own region may not.

The Strategic Panel would support ambitious national targets for wholesalers to roll out enhanced metering across both household and NHH customers with common interoperability standards. For example, 100% enhanced metering coverage by 2030 – importantly this target would align with the water industry’s targets around water efficiency and net zero.

In lieu of a national strategy for 2030, we would encourage Ofwat to set a clear direction for water companies in prioritising metering rollouts to:

- Customers operating in water stressed areas;
- Customers using a certain volume of water;
- Customers with hard to read meters; and
- Customers who have requested enhanced meters.

The Strategic Panel also recognises that effective meters, meter asset health, and meter reading processes and technology underpin the delivery and maintenance of good quality data. Addressing the causes of poor data quality must be a priority for the market. Enhanced metering technology that provides accurate and timely information to customers and market participants is key to achieving excellent customer service, water efficiency and added value.

The Panel believes that a wider vision around metering, looking beyond demand reduction, could help tackle longstanding frictions around data quality as well as enabling NHH customers to better understand their water use and opportunities to use water more efficiently. There appears to be a gap in the draft methodology in terms of better data and how it can drive improved outcomes.

There is also no visibility at present around how much and how far metering investment will be proposed at PR24, although this should improve in the autumn. While the reformed MPF will have a role to play, metering remains bound to decisions by Ofwat as part of PR24. The Panel acknowledges that some of these benefits will be hard for wholesalers to fully quantify in their business cases but should still be considered.

The [Strategic Metering Review](#), led by MOSL, seeks to identify and implement a programme of metering-related improvement initiatives, with a focus on accurate and timely consumption data. A report the Metering Committee commissioned Artesia Consulting to deliver highlighted a strong business case for investing in [enhanced metering technologies](#) for NHH customers as part of wholesalers’ PR24 plans. A second report, looking at options for possible changes to the current meter-related [roles and responsibilities](#), was also recently published, led by PA Consulting.

Some of the options considered in this review might require changes to the price control arrangements where they alter the roles and responsibilities of market participants, we would like to see Ofwat engage more actively with the findings of this work, including taking decisions to implement regulatory changes where required, based on the Panel's recommendations. We would like to work with Ofwat to ensure that these proposals can be facilitated by the PR24 methodology in December.

The Panel believes there is currently a disconnect between the work MOSL has done around enhanced metering technologies and roles and responsibilities, as part of the Strategic Metering Review, and the Water Resource Management Plans (WRMPs), which will ultimately provide the driver for metering across different regions. Visibility of plans for enhanced metering between wholesalers and across the market will be crucial to drive implementation across regions and we expect this to emerge in the autumn. The sharing of learnings from wholesalers, who are already deploying NHH enhanced metering, will be a key part of this.

The Panel believes there could be merit in updating the work by Artesia on the business case for enhanced metering in the NHH market once the draft WRMPs are published.

Any changes in roles and responsibilities must leverage the best of the skillsets from wholesalers and retailers. A centralised approach on NHH metering interoperability would help standardise data and the customer experience of NHH enhanced metering across regions. We would welcome support from Ofwat to require such a standard to be introduced.

Where gaps remain in the implementation across the NHH market (i.e. a region which has plenty of water, like the North or West, is not proposing much, if any, smart meter implementation), market participants should be allowed to make a separate case for additional smart metering investment specifically for NHHs (wholesalers and retailers funded case or MOSL funded case). This would make sense where a) the WRMP process doesn't identify a clear need for more metering more rapidly in a specific region and b) reflect the costs and benefits of the market which might not be so well reflected in the WRMP process. We would like to work with market participants on this case in the autumn when we have greater visibility of the arrangements proposed in the WRMP.

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?

The Panel 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 final methodology must ensure an appropriate focus on reducing non-household and household demand. The Panel is concerned that 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.

The Panel agrees with Ofwat on the importance of wholesaler and retailer collaboration to help NHH customers use water more efficiently. Additionally, clarity is needed on 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.

The Panel 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.

The Panel believes there may be merit in drawing parallels with the electricity sector where there are financial agreements in place for large users to reduce or stop their usage at times of high demand in order to benefit the system. The differences in structure between the water and energy sector are appreciated, but the Panel believes there could be merit in exploring such an approach as it could compare favourably to the costs of, for example, building an extra reservoir to meet that demand. It should be noted, however, that the Panel believes this work is essential, regardless of cost-offsetting, to build greater resilience in our water supplies. We would be pleased to work with industry to explore these opportunities if this is considered a current gap.

Upstream competition

The original review of the water sector undertaken by Professor Martin Cave in 2009 which recommended the creation of the NHH market also highlighted the potential for a 'bi-lateral' model of competition where third parties could trade water with retailers directly.

The Strategic Panel understands that the legal arrangements to give effect to these changes are already in legislation but would require further work, including by Ofwat. We support Ofwat's proposed approach not to take this work forward for PR24, but to revisit the prospect of bi-lateral market entry for PR29. We believe focus must remain on fixing the existing challenges with the market arrangements, but we would similarly

support a wider review ahead of PR29, as these proposals have the potential to provide further benefits to customers in the future, when fully considered and at the appropriate time.