

7th September 2022

Emailed to: PR24@Ofwat.gov.uk

Reference: Consulting on our methodology for PR24

Dear Sir/Madam,

Thank you for providing us with an opportunity to comment on the proposed methodology for PR24. As a Retailer in the non-household water retail market (the "Market"), we can provide a key perspective on how the upcoming price review will impact the Market and its customers.

The following areas will need to be prioritised to ensure wholesaler business plans deliver for the Market, including retailers and non-household customers:

- Greater incentivisation of wholesalers to enhance service within the non-household market
- Clear focus on and resourcing of water efficiency measures
- Improvements to the metering network, including smarter metering

We have set out our views on each of these areas below, and where appropriate we have responded to the individual consultation questions in the appendix attached.

Greater incentivisation of wholesalers to enhance service within the non-household market

Wholesalers play a key role in the Market, and retailers are dependent on wholesaler performance in many aspects of the market. For example, the accuracy of customer billing is highly dependent on wholesaler owned market data such as the location of meters and the charges applied. Inaccurate customer billing not only drives poor customer outcomes, but it also additionally leads to delays in the recovery of charges to retailers. Where this occurs, Retailers remain required to pay wholesale charges through the settlement process and incur both the additional cost of capital to finance these charges and the increased risk of non-payment even when not at fault. Whilst wholesaler policies, processes, and performance can have a significant impact the service received by non-household customers, and on the reputation, performance and profitability of retailers, there is relatively little incentivisation on wholesalers to effectively engage with and resolve the well-known issues facing the Market such as the poor quality of market data. There has been insufficient incentive on wholesalers to date to resolve data quality issues stemming from market opening, which is estimated by an Economic Insight report to lead to annual friction costs between £6 – 24 million between retailers.

Existing financial incentives (primarily through the market performance framework) have been both relatively small and specifically targeted towards transactional performance, with no clear reward for strategic improvement or consistency between wholesale regions. Ensuring that there is strong incentivisation not limited to transactional performance will aid the market in addressing key issues and frictions.

It will be important that the correct balance between qualitative and quantitative analysis is struck when assessing wholesaler performance and would encourage Ofwat to retain elements of the survey-based approach currently within R-MeX. Providing opportunities for meaningful qualitative feedback and targeted input on a variety of specific issues by wholesaler, such as the significant delay in receiving wholesale refunds, will be critical for the required market development.

We broadly welcome “BR-MeX”, as the introduction of a specific performance commitment to capture the perspectives of both business customers and retailers should lead to an increased awareness of, and prioritisation, of this area. To best ensure that this incentive is effective, it must carry a sufficient financial reward or penalty proportionate to equivalent measures such as C-MeX.

Clear focus on and resourcing of Water Efficiency measures

The need for improved Water Efficiency within the market is clear, promoting not only environmental outcomes but also working to improve the sustainability of the sector. DEFRA has recognised this case for improvement and established ambitious targets for the water industry including a 9% reduction in non-household demand by 2037. Such ambitions are justified, however significant change in the sector will be required to deliver this level of change. As part of PR24, we would like to see that adequate funding for pro-active Water Efficiency measures are captured as part of the price control. This would include not only wholesalers ensuring the improvement of network resources to reduce leakage, but to also raise customer awareness of the issue and proactively push for reduced usage.

Effective engagement with customers will require collaboration between wholesalers and retailers, as whilst retailers own the relationship with business customers it is the wholesaler who is better funded and incentivised to tackle this issue. Whilst the role of customer engagement sits with the retailer, there is not sufficient funding for retailers to make the most of this position to drive for improved efficiency. We believe PR24 should not only fund and incentivise wholesalers to improve their own direct performance, but also provide sufficient funding and opportunity to enable and incentivise proactive efforts within the retail market.

This model of wholesale funding and incentivisation of retailer activity on water efficiency has previously been successful, for example within the rollout of School Water Efficiency Audits in the United Utilities area. This successful project was wholesaler led and funded, with retailers providing support. With adequate funding, it was possible for the market to proactively identify many leaks and potential water saving measures. Within 30 water efficiency site visits, 219 leaks were fixed, and 228 water efficiency devices were fitted saving on estimate around 265,000 litres a day. Following the success of these pilot schemes, we believe that it is critical for such joint activity between retailers and wholesalers to be encouraged and incentivised.

We welcome the consideration to potentially exclude water companies from receiving associated overperformance payments where other market participants, (e.g. retailers, third parties) are not sufficiently engaged. It is our view that the significant potential for collaboration on water efficiency is currently underutilised. We would appreciate additional clarity on what would qualify as this engagement, to ensure that such opportunities are maximised.

Improvements to the metering network, including smarter metering.

Enabling the collection of accurate and timely consumption data is a fundamental requirement of an effective water sector. Issues in obtaining meter reads have the potential to drive significant customer dissatisfaction by leading to inaccuracies in billing as well as distorting the true level of consumption in the market.

Whilst the role of meter reading in the non-household market is undertaken by the retailer, the assets themselves and the surrounding data (for example, their location) remain owned by the wholesaler. As such, meter reading itself has several key dependencies on wholesaler performance that we believe are not adequately addressed or incentivised within the existing proposals.

- The availability and quality of meter data is inconsistent in the market
- The current rate of rollout of smart metering is not fast paced enough to deliver for the market
- Support for existing smart meters and third-party metering technologies is inconsistent and, in many cases, insufficient. For example, there are many cases where data loggers are being disconnected during routine maintenance of the wholesale asset yet there has been no reconnection or notification to the retailer.
- There is no clear market wide direction for metering, potentially leading to huge variation in approaches between different wholesale regions. Ensuring that the market develops in a uniform direction, with clear standards and technical compatibility will be critical.

The Price Review represents an ideal opportunity to promote a co-ordinated metering strategy, messaging, or target to resolve these issues. Any such strategy should ensure that wholesale companies are adequately resourced to increase the rollout of smarter metering (including for the Market) and challenged to improve the quality of metering data so that good quality and timely reads can be obtained. These improvements will create significant benefit to the non-household market and its end users, most importantly ensuring that customers can be billed to accurate actual reads with greater regularity.

Due to the significant need to ensure high quality consumption data to achieve desired market outcomes, particularly water efficiency and customer satisfaction, we do not believe that focussing on this area primarily through the Water Resource Management Plan process will be sufficient. It is our view that there should be clear market level direction contained within PR24, setting out clear ambitions for all wholesalers to drive improvement.

Please do not hesitate to contact us if you wish to discuss our views further. You can reach out to either myself, or the Regulation Team at Regulation@water-plus.co.uk if you wish to discuss any part of response in greater detail.

Yours sincerely,

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Appendix 1: Consultation Questions (by Chapter)

Ch2 – Regulating through the price review

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

In addition to the challenges facing the sector listed, we believe that the frictions present within the non-household market are sufficiently detrimental to end-users that it warrants inclusion as a challenge facing the sector. The performance and approach of wholesalers within the market are material, with data quality and inconsistency in processes and policy driving delays and dissatisfaction amongst the customer base.

At a high level, the four ambitions listed represent a very positive baseline for assessment throughout the PR24 process as they touch upon each of the key areas challenging the sector. That said, it is our view that some small amendments to the existing proposals may provide greater scope and clarity for wholesalers when generating their business plans.

One such suggestion would be the expansion of the “efficiency and innovation” ambition to “efficiency, innovation and collaboration”. When considering the long-term issues within the sector, notably water efficiency, it is our view that such co-operative engagement will be absolutely required to deliver the level of meaningful change required. In addition to the sharing of best practice between wholesale companies, the potential benefit of collaboration between wholesale companies and water retailers has not yet been truly realised and should continue to be promoted.

Within reflecting “a clearer understanding of customers and communities”, we would request that understanding the needs of retailers as a wholesale company customer should be clearly included as part of the ambition.

Ch4 - Reflecting an understanding of customers and communities

Q4.1. Do you agree with our approach to making sure that companies' price review submissions and our determinations reflect an understanding of customers', communities' and environmental concerns?

Water Plus is concerned that that specific definition of customers as “the end users, that is residential and business users of water and wastewater services” is limited and has the potential to lead to the exclusion of water retailers from discussion and consideration. It should be noted that as part of the non-household market retailers represent the single largest customers of these wholesale companies, and their own performance is materially impacted by the quality of service received by wholesalers. Poor wholesaler performance not only disadvantages the retailer as a customer themselves, but also the non-household customer through additional delays and potential inaccuracy. As such, it is critical that an understanding of retailer perspective and requirements can be captured and considered whilst developing business plans.

Ch5 – Delivering outcomes for customers

Performance commitments

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

Water Plus recognises the clear need for a strong package of performance commitments within PR24 to incentivise action on water efficiency. Recognising the ambitiousness of the 9% reduction in non-household consumption by 2037 target established by Defra, it is critical that strong incentives, strategic direction, and effective collaboration will be required by all industry participants to deliver against this aim. We strongly support the introduction of a specific “non-household demand” performance commitment.

We welcome the consideration of disallowing outperformance rewards for wholesale companies cannot demonstrate exploring options in collaboration with other market participants (not limited to retailers). As retailers own the relationship with non-household customers, they are well positioned to support wholesalers with the rollout of water demand management strategy however such engagement has been inconsistent within the market.

It is our view that separate performance commitments should be included for each of the areas considered to ensure that these measures are clear, sufficiently focussed and do not dilute each other. Within a single combined measure, there is the potential that specific circumstances may make increased focus on one single aspect individually more ‘cost-effective’ to the detriment of the other aspects.

We do not support the exclusion of non-household customers using greater than 50MI a year, as these large users represent a significant percentage of the demand in the non-household market. Whilst their inclusion may increase the volatility of performance if unaccounted for, these sites typically represent the highest potential for efficiency gains on account of their high usage and as such should be included within the incentive structure.

As previously discussed in our cover note, the assessment of performance against these criteria is going to be heavily reliant on the quality of consumption data available within the sector. The quality and availability of metering data, slow roll-out and support of smart metering in addition to the frequency of unmeasured sites will all present challenges to the effectiveness of such policies. We believe a stronger market strategy on the metering challenge will be required, potentially including specific incentives on the quality of metering data within the market.

Standard incentive rates

Q5.4. Do you agree with our proposed approach to the measures of experience performance commitments, including to increase the size of C-MeX?

Water Plus broadly supports the incentivisation of wholesale companies providing improved customer service, and as such welcome the consideration of strengthening the financial rewards associated. It is important however, that the relative scale of all such measures (including BR-MeX) remain proportionate to ensure that such other measures are not diluted. If the size of C-MeX is to be increased, it is important that the financial incentives associated to the new BR-MeX are similarly considered such that they remain in line.

Appendix 6 – Performance Commitments

Customers receiving excellent service every day

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?

Water Plus agrees with the Ofwat assessment that "PR24 provides a better opportunity to introduce a strong and targeted financial BR-MeX incentive" than the Market Performance Framework as identified in Appendix 6. As such, we support the inclusion of common performance commitments to incentivise both ensuring business customer satisfaction when engaging directly but also ensuring retailers can provide better customer outcomes by reducing frictions in the market.

Whilst we welcome the inclusion of additional incentives in this area, it is our view that by combining both B-MeX and R-MeX into a singular measure could potentially dilute the incentive. Whilst both measures seek to improve the outcomes for non-household customers, each measure is likely to focus on and assess slightly different aspects of wholesale impact. We would encourage Ofwat to consider establishing two separate incentives, enabling B-MeX to capture the impact of Wholesalers on business customers directly and R-MeX to ensure that market frictions, inconsistencies and delays do not eventually lead to poor customer outcomes.

Within the proposal for BR-MeX, we note that the proposed over and under-performance payments (+0.5% to -1% respectively) are established to only apply to non-household revenues. This approach to segmenting ODI impact represents a departure from existing methodologies that does not appear inherently justified; and would further dilute the level of incentive such measures will represent. It is our view that the level of reward and penalty for these measures will need further consideration, as we do not yet have confidence that the proposed incentives are sufficient or correctly aligned to the level of C-MeX.