THE WATER REPORT
POLICY | REGULATION | COMPETITION
JUNE 2015

Highland gains

Anglian Water Business MD Bob Wilson is set to supply a quarter of the Scottish market

COMPETITION WATCH

- Open Water transition update and outlook for the Baseline Review.
- Market readiness: issues for incumbents and new entrants to consider.
- Programme separation: no regrets business change and not reinventing the wheel.

THE WATER REPORT COMPETITION WATCH

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EDITOR'S COMMENT

What prospects for the Baseline Review?

Top of the list of key risks to successful retail market delivery, as stated in the Assurance Framework Open Water published last month, is "uncertainty and continuing changes to the governance structure, decision making framework and roles and responsibilities leading up to April 2017". Deloitte says this "has the potential to create delays, lose delivery momentum and impact the success of market opening".

And yet only a few weeks after publication of that document, we are hit with yet another batch of governance change. Ofwat and MOSL's takeover of responsibility for the Open Water programme was not complete by 31 May as had been touted; OWML will stay on until the end of July.

We can only speculate this eleventh hour development was a result of either or both the parties due to pick up OWML's work not being quite ready to do so. If this is the case, it may indicate all is not well with the Baseline Review – an independently performed spot check that is expected to offer a confidence rating on market delivery and recommendations. This was conducted to coincide with the scheduled transition, and Ofwat is expected to publish the findings later this month.

The patience of all Open Water participants must be wearing thin, and with timetable pressures beginning to get really intense, it is easy to imagine that collaboration might break down and parties might start pointing the finger at each other. This would be a grave mistake.

There are risks enough to deal with without this: what if levels of engagement or activity falter? What if MAP pre-vendor recommendations are not published by July? What if there are any hold-ups with Ofwat's chosen delivery partner PA Consulting starting work? What if companies prepare inadequately? The list goes on.

It is for this reason, and because of the limited time available and the plentiful workload that remains outstanding, that all market participants must redouble their efforts to work together. There may be more "uncertainty and continuing change" to come. The Baseline Review may not make entirely happy reading. But even if that is the case, its findings must be used constructively. If it highlights gaps and weak spots in the programme, through non partisan eyes, it should be viewed as making a positive contribution and should encourage parties to work together to find the most appropriate solutions and keep delivery on track for business customers.

| *See transition update, p23 and report p24-25.*

Karma Ockenden, editor,
The Water Report

Feedback, comments and suggestions very welcome.

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OTHERS WEIGH IN TO BRISTOL APPEAL

Companies and customers share their views on Ofwat's cost assessment model, WACC and comparative analysis at the CMA

Hearings are underway this month in Bristol Water's price determination appeal to the Competition and Markets Authority (CMA), with provisional findings due early next month.

The positions of the two protagonists are well established. These are summarised in the box for reference.

But what have others said? The CMA invited submissions from interested parties and has published those received from Wessex Water, Dwr Cymru, Anglian Water, the Consumer Council for Water, the Drinking Water Inspectorate and Bristol's Customer Challenge Group the Local Engagement Forum (LEF). Their take on the key issues is instructive and provides an indication of support or opposition to Bristol's position.

Totex cost assessment

While there is no reference to Bristol's specific circumstances, two water companies weigh in to share their lack of confidence in Ofwat's cost models. Anglian offered up to the CMA the submissions it made to the regulator in June 2014, which set out what it calls "systematic errors in Ofwat's cost modelling". In the case of wholesale water, the area most relevant to the Bristol case, Anglian lists five main "reservations" with the cost assessment modelling approach taken by Ofwat and calculates that "the impact of making the proposed remedies to all issues is to add at least £53.8m to the water threshold" (there is an equivalent number for wastewater wholesale, £79.7m).

Wessex likewise flags up to the CMA the issues it raised with Ofwat in summer 2014: that its cost assessment approach takes no account of differences in existing service levels and delivery of outcomes; takes limited account of future changes in service levels; and that modelling uncertainty has increased since PR09 but so has the efficiency challenge.

Wessex then goes on to point out that whether Ofwat's model is robust or not, it does not believe it is in consumers' best interests. The company explains: "Evidence suggests that the overall totex-based cost assessment approach used by Ofwat rewards companies that are proposing to spend less rather than those proposing to spend efficiently on the right things."

It says there is an incentive for companies to avoid proposing cost-beneficial improvements to outcomes for customers and the environment because those who avoid additional investment are subject to less scrutiny; receive a lesser efficiency challenge; are more likely to gain the financial and reputational rewards of enhanced status; and will gain a reputation for efficiency.

It observes: "Given the challenges faced by the sector of increasing customer expectations, rising populations, climate change and deteriorating raw water quality we question whether this model of assessing wholesale expenditure moving forward is in the long term interest of water consumers."

Dwr Cymru in contrast endorses Ofwat's process and methodology for assessing the level of allowed expenditure. Its submission says: "We welcome the more innovative approach taken which recognises the inherent complexity of modelling heterogeneous companies."

Understandably, neither customer representative delve into the detail of the cost model. CC Water welcomed the cost challenge , provided outcomes can be delivered at efficient cost. The LEF however said it was content with independent assurance provided for the company's cost estimates and the asset planning methodologies employed and it supported the overall package of work and the associated bill impacts.

Cheddar 2

The Cheddar issue poses a different question: at stake is whether it needs to go ahead at all as Bristol proposes in 2015-20, not what it would cost. The company's position is shaken by a change of heart from CC Water. The customer body initially supported beginning preparatory work for the scheme in 2019-20 to help spread the cost over a longer period. But in light of new evidence, its submission says the company should reassess its assumptions on available supply and headroom, and reconsider using smaller sources of supply ahead of the Cheddar 2 build, allowing it to be delayed.

Notes summarising CC Water's CMA hearing explain: "CCWater had received updated information about the water needs of the Seabank power station. CCWater thought that demand across Bristol Water's area of supply would be less than anticipated and therefore Cheddar Two would not be needed before 2030. It also said that Bristol Water was pessimistic around household demand in comparison with other companies and it thought Bristol Water's headroom analysis was out of kilter with the rest of the industry and did not meet the Environment Agency's guidelines."

In its hearing, the LEF seemed to remain supportive of the scheme, explaining it had emerged as the best option out of 150. It said that at worst, Cheddar 2 could be delayed by one review period, but should not be allowed to drift any later.

WACC and financeability

Bristol's prospects for getting upward movement on the WACC won't be helped by the stony silence on the issue from its fellow companies. A supportive voice from a water only company would have been particularly useful. CC Water supports Ofwat, slamming Bristol's proposal for a 4.37% WACC when all other companies are making do with 3.74% (3.6% wholesale).

Again, the LEF offered support to the company. It shared its concern in its hearing that a lower cost of capital might prejudice delivery of customer benefits or risk Bristol Water being unfinanceable.

Customer outcomes

Bristol's case seems to have opened old wounds in terms of Ofwat's late intervention in company performance level targets and Outcome Delivery Incentives (ODIs) on the back of industry wide comparative analysis in six areas. Some companies have taken the opportunity to air the grievances that first surfaced in October 2014, when they responded to the draft determinations.

Dwr Cymru, supportive overall of Ofwat's conduct of PR14, points out to the CMA the following: "The business plans were constructed after careful consideration of customer preferences and cost and bill impacts of the various options. This resulted in the balanced final plan submission within which the financing of the plan and the performance targets proposed were inextricably linked. A unilateral change to these performance targets at a late stage in the process without time or process for proper consideration and little or no recognition of the cost or price consequences, or even our customers' preferences, means that the outcome was more crude and unsatisfactory than it had to be."

Anglian Water has submitted to the CMA an extract from its October 2014 representations. This draws attention specifically to the the interruptions to supply ODI and the company's view that the committed performance level had been set without reference to the inherent differences in companies' networks which inevitably affect performance.

CC Water supports Ofwat's comparative interventions, urging a consistent approach to setting performance targets that reflect the upper quartile across the industry. It takes the opportunity to reiterate its position that customers don't support financial performance incentives.

In a broader sense, the case poses questions about the role of the customer in price setting, and specifically, to what extent the customer should have decision making capability on price and service. As endorsement for its plan, Bristol can point to a massive 92% acceptability rating from customers and clear support from the LEF (which insists its challenge was robust and shrugs off accusations that the customer engagement used to support the proposed totex was weak and "superficial"). Ofwat powering in with a substantially different view of appropriate price was clearly far from welcomed. Notes on the LEF hearing report: "Because of the timing and scale of Ofwat's intervention that went against the proposals that the LEF had found that customers had supported, it concluded that Ofwat did not adequately weight or value the views that customers had expressed."

In the round, while not all the third party submissions refer to Bristol's situation specifically, evidence has been presented to both endorse and rebuff the company's position. Judging purely from the third party comments, there seems to be little support for Bristol's WACC position, and support for Cheddar 2 has thinned. But on the core issue of cost assessment, there clearly are those who sympathise; likewise on the comparative analysis issue.

It would have been good to hear a few more voices contribute. The consequences of the CMA finding in Bristol's favour – particularly on cost models and WACC – would be of import to the wider sector. Though perhaps silence can be read as nothing to say. TWR

THE KEY ISSUES IN BRISTOL'S APPEAL

Totex cost assessment: The final determination in December cemented in a 32% gap between the company's proposed totex of £541m and the regulator's number of £409m. With the notable exception of funding for the initial construction phase of the Cheddar Reservoir Two scheme which Bristol factored in but Ofwat excluded, the gap stems from a different view of efficient costs.

Bristol argues Ofwat's cost model is flawed: built with a one-size-fits-all approach, and unable to account for different company situations. The company argues that accepting the wholesale determination would not be in customer best interests because the £409m figure is insufficient to maintain its levels of service and investment.

On the Cheddar reservoir specifically, Bristol argues the scheme has local support and is "the most economic and environmentally sound solution, satisfying future demand for water arising from population growth and additional commercial activity".

WACC and financeability: Bristol's business plan put in for a small company premium of 70 basis points. This was rejected in the FD and Bristol is now taking the matter up with the CMA.

In addition, the company believes the final determination renders it unfinanceable.As a result of Ofwat's much tighter totex number and the fall in allowed returns, the final determination imposes a 21% cut on the average Bristol Water bill over five years, down from £202 in 2014/15 to £160 in 2019/20. This is the greatest percentage reduction in the sector, and over four times the industry average five year bill cut of 5%.

Outcomes for customers: Though not cited as a reason for the appeal, Bristol raises another area of difference with the regulator: the latter's interventions in plans following comparative assessments across the industry. This affected six common areas: supply interruptions; customer contacts on water quality; water quality compliance; sewage pollution; sewer flooding; and leakage. Bristol has raised issues on its performance targets for unplanned supply interruptions, negative water quality contacts and mean zonal compliance.

The company also stresses that a hefty 92% of customers considered its business plan acceptable.

Ofwat's response: Its trump card is that all 17 other water companies accepted its cost modelling, risk and reward judgements and comparative interventions in performance commitments. Its response to Bristol's statement of case asserts: "We maintain our view that the final determination we set on 12 December 2014 fully satisfies our duties in respect of all stakeholders. In particular, the final determinations furthered the consumer objective and will enable an efficient company to finance its functions and earn a reasonable return. These also allow for Bristol Water, operating efficiently, to deliver efficient investment in line with appropriate long-term plans in order to provide long-term resilience of its water supply system."

On the totex cost assessment point specifically, Ofwat robustly defends its cost model and advises that Bristol's totex gap could be bridged through further efficiency savings and/or by Bristol reconsidering the scope of its programme – something the company contests.

Ofwat points the finger back at Bristol: "Although the remaining gap between our cost projections and its business plan forecasts of costs are large, this is understandable given the greater than 50% increase in Bristol Water's base costs that occurred between 2010-11 and 2012-13."

It stands by its position that Bristol has failed to provide convincing justification for Cheddar 2; rejects outright the appellant's WACC arguments on both debt and equity; and defends its comparative assessments.

THE CASE FOR A CATCHMENT SYSTEM OPERATOR

In a compelling new paper, Dieter Helm calls for speedy water market reform that would combine central planning by a catchment system operator with broad competition to provide system services.

On its travels through the industry over the past few months, *The Water Report* has been soliciting views on whether or not a system operator (SO) will be needed should upstream markets be reformed. It is a logical question to pose: if water services become more fragmented and more parties are involved in performing them, who will coordinate the activity, safeguard security of supply and ensure investment is made where it is needed? With a few notable exceptions, we have mostly drawn blank looks or an indication that an SO might be something to consider at some point in the dim and distant future, but not now.

But according to leading economist and academic Dieter Helm, now is very much the time to introduce system operation to water. In a paper published last month, Helm makes a compelling case for the establishment of a catchment system operator (CSO) for each main catchment – and urgently. "These reforms should be done well ahead of the next water periodic review process, and form the basis of a new and comprehensive water act," he says.

Helm's vision is for a CSO to operate in each catchment, with responsibility for planning and coordinating catchment functions in an integrated way. This could include abstraction, discharges, flood defence and agricultural subsidies. The CSO would not perform any of these functions itself but rather tender them out to a wide range of companies and organisations, including water incumbents, new entrants, farmers, land managers, facility management firms and not-for-profit organisations. "The market for delivering capital and operating services would be dramatically opened up," Helm relates.

According to the paper, the benefits of reform of this kind would be considerable, including: a reformed abstraction system and the associated benefit for water bodies; integrated flood defence solutions; agricultural subsidies that maximise natural capital benefits; responsible new development; and efficiency gains from much greater competition.

Good timing

Rumour has it the paper has been brandished with enthusiasm by the new water minister. Be that exaggeration or not, it is certainly the case that Helm has timed his publication well. If there is any appetite to adopt the reforms he proposes, now is the time to act. Not only is there a new ministerial team at DEFRA, but Ofwat's Water 2020 work is ramping up with an issues paper due in July. Moreover, abstraction reform has been promised, opening the door to new legislation. Helm points out: "In the second half of 2015, there will be the opportunity to bring these issues together to create a long-term sustainable and overarching management of these natural capital assets. The Coalition government has promised to legislate on abstraction after the general election, whilst a number of interested parties are campaigning for a Nature Bill."

Helm's ideas are not entirely novel for the sector. Companies including Wessex Water and South West Water who have contributed to other articles in this upstream reform series have previously told The Water Report that they are looking into bringing buyers and sellers of upstream services together and exploring Payments for Ecosystem Services markets. Helm in fact acknowledges in his paper that Wessex Water has been a particular source of support and assistance as he has developed his theme. But he strikes out in making proposals on, not just on how local services might be provided by a range of parties a market basis, but on how such markets might be planned, developed and managed at a catchment level.

A new dawn? The electricity SO provides lessons on how a CSO could work

Coordinated competition

Helm starts from a position of being distinctly unimpressed by the status quo (see box p8). He discounts both the currently favoured competition model and the polar opposite of direct planning within the public sector as being unable, individually, to find solutions to water problems and to deliver optimal outcomes. He favours instead "coordinated competition" – a hybrid option which sees markets working within rules and frameworks. In water, this would manifest itself as central system planning by the CSO combined with competition to provide system services.

Helm says what he has in mind is most akin to the role performed by the electricity SO, National Grid. Specific functions a CSO might perform are:

- Day-to-day control and allocation of water abstraction
- Day-to-day control and regulation of discharges from sewerage treatment works
- Day-to-day flood management
- Day-to-day oversight of environmental schemes in agriculture
- Planning flood defence
- Planning sewerage treatment and abstraction investments and long term management
- Planning the development of CAP environmental subsidy requirements and other land management dimensions
- Providing an overarching natural capital framework for catchments.

Helm stresses that the SO shouldn't carry out any of these functions itself: National Grid does not generate electricity, and Network Rail does not run trains. Nor should it have regulatory or prosecution powers in respect of pollution. Instead it "would be required to develop, consult and implement a catchment plan (CP), and set out a long-term framework (say 25 years). The CP would be directly linked into the national infrastructure plan and the 25-year national natural capital plan proposed by the [Helm-chaired] Natural Capital Committee".

The paper argues two key areas that would benefit are:

- **Abstraction:** Planning and management would lie with the CSO. It would be able to manage the river catchment as a whole and optimise the water abstracted. Helm notes: "The costs of abstraction vary by location, and by setting prices to reflect these variations, the private sector can then take the commodity, use it and then where appropriate sell it back to the CSO. One approach would be to set up a "water bank", and manage this bank to optimise the system." Of course the abstraction system would need to be reformed. The government has committed to do this anyway.
- **Flood defence:** The CSO would develop catchment-wide, long-term flood management plans, bringing flood defence within the framework of agricultural subsidy and land management. It would have particular regard to the management of the upper catchments, and their ability to absorb and hold water.

Impact on players

Of course the roles performed by the sector's key players would alter substantially. Incumbent water companies will no doubt be relieved to learn that Helm says the regulated asset base (RAB) would remain undisturbed by his proposed reforms. But they would have to compete to perform services that may have hitherto been monopoly functions. The paper offers some examples: "An upstream nature reserve, a national park or a re-pasteurisation project might alleviate the need for hard capital works downstream, and landowners could bid with projects too. The CAP subsidies could be made partially competitive – in terms of which land management schemes on which farms offer the best environmental and flood protection. Facilities management companies and infrastructure companies might compete head on, as well as in co-operation with, water companies."

There would also be opportunities for growth for incumbents. "As companies with key competitive advantages in the management of water and wastewater, in managing water treatment works, and sewerage works, it is to be expected that they would be companies with much to offer in taking over a number of flood management services – both in carrying out projects and in facilities management services. They may also have an interest in land management."

Over time, says Helm, traditional water company boundaries could erode: "Some would specialise and fragment; others might take on wider ambitions and enter the new flood defence and land management markets. What would change would be the boundaries of the water companies which would become much more porous." In addition, the CSO would take over some functions currently performed by companies – for instance, services surrounding resilience and sustainability.

In a similar vein, there would be far reaching implications for the Environment Agency too. Not only would the CSO take over some functions currently performed by the agency as it would with companies, but most of the EA's flood defence workforce would likely end up with the suite of new service providers competing for this work. Helm sees this as a positive step: "The EA could then go back to what it was designed to do: integrated pollution control through pollution regulation, pollution monitoring and pollution prosecution. It could become a serious Environmental Protection Agency."

As for Ofwat, it's job would be "to ensure that that the resulting markets are competitive and to protect customers in the residual monopoly roles".

Funding

The paper closes on a practical note: how might all this be funded? Helm doesn't have detailed answers, but is not down hearted. For one thing, existing sources of income – from water bills, tax for flood defence, CAP subsides, flood insurance, voluntary contributions and developer contributions – could be reallocated between the CSO, the water companies, the environmental trusts and the farmers in line with the new model.

But Helm sees more value in taking an alternative route: relating funding to beneficiaries. In the same way as electricity network users pay use of system charges, so all beneficiaries in a catchment could pay a "catchment system charge" – perhaps as part of their water bill, or added to their Council Tax bill as police charges are, or even collected via a new "water catchment services utility bill". The Treasury could pay on behalf of all the people in the catchment who benefit from CSO services, while there could also potentially be a household CSO charge for those facing elevated flood risk.

On top, new sources of finance could be tapped – for example, green levies and charges for pollution for those who damage river catchments. There could also be compensation payments from those who damage natural capital, for instance by building on flood plains which raises the flood risks to others, and increases the need for flood protection. These payments could be used to mitigate the impacts of developments. "A natural capital fund would be one possible mechanism for channelling such compensation and pollution charge revenues," the paper says.

Helm goes further and sketches out the concept of a"catchment balance sheet" for natural and physical assets, with capital maintenance charges for asset maintenance and capex financed through borrowing. Helm remarks that "this might form a CSO RAB, but there are clearly other options". He adds: "This sort of capital structure is very familiar in the water industry. The RAB plays a central role here: it provides comfort to investors that their investments will not be expropriated by opportunistic regulators, given that there is a classic time inconsistency risk to the investors. The better the guarantee, the lower the cost of debt, and the CSO model proposed here would be more cost effective if the implicit guarantee to honour the RAB was made more (rather than less as Ofwat propose) explicit." TWR

Dieter Helm's paper Catchment management, abstraction and flooding: the case for a catchment system operator and coordinated competition can be found at http://www.dieterhelm.co.uk/node/1405

CURRENT PROBLEMS AND CHALLENGES

Helm describes the status quo thus: "The current state of river catchments is not sustainable. Current abstractions are seriously inefficient and have in a number of catchments serious economic and environmental consequences. Flood defence is short-term and inefficiently planned and managed. The catchment natural capital is often in decline. Integrated pollution control is muddled up with production activities in the EA."

Reforms to date, he observes, have been piecemeal, have failed to produce either cost effective or sustainable catchment management, and have neglected to address abstraction and upstream reform, flood defence and the integration of agriculture with water quality and ecology.

The CSO paper sets out the main challenges that need to be urgently addressed:

- **No one in charge.** Unlike in electricity where National Grid performs the SO role, no one party has overall responsibility for river catchments. This results in "seriously sub-optimal" outcomes. "The water sector in 2015 comprises a complex web of companies with different ownership structures, with multiple relationships with regulatory bodies covering pollution control, drinking water, abstractions, and farming practice, a number of different organisations engaged in flood defence, a diverse farming and forestry sector, and finally a number of environmental trusts, groups and organisations."

- **Water companies' functions are narrow and their attention is dominated by price controls.** "The regulatory model has effectively made companies contractors – carrying out the functions defined in the licences for fixed priced contracts. The government has already added new functions, beefing up the sustainability and the resilience requirements. This is clear recognition that the boundaries of the water companies' functions are less than optimal, and that key considerations have been falling between the cracks."

Having narrowed the function of the water companies, many of the other functions which water authorities once carried out have had to be provided by other organisations. Environmental quality and river management went to the National Rivers Authority, but this was subsequently merged into the Environment Agency, on the argument that pollution control should be "integrated". But water pollution control has remained largely separate from the environmental regulation of land, and water quality regulation has been dominated by policy from Brussels.

- **Competition:** Ofwat is pursuing a classic strategy of incrementally opening up more and more market segments to competition. Yet experience from other sectors shows things don't always go to plan. "In rail, competition between rival train services on existing lines has effectively been abandoned and in electricity a central buyer model has now been put in place determining investments through government-backed contracts. Rail customers cannot switch, and in energy switching has not delivered a competitive supply market. In both rail and energy, public confidence has deteriorated significantly."

- **Long-term flood defences under short term Treasury financial control.** As a public sector body, the EA is subject to Treasury control and budgeting. Its capital spending is determined within the framework of the Comprehensive Spending Reviews, and hence is inevitably short term; nor can the EA borrow to invest as a private company would. "Paying for flood defence has therefore been a struggle, and the EA has tried to find additional funding, through partnerships and eliciting other contributions. This risks being a zero-sum game – the Treasury has the option of reducing its funding as and when other sources arise."

- **Agriculture is another world.** Neither the water industry nor the regulators have much control over land use and in particular agricultural practice, despite the fact that agriculture is highly subsidised.

VIEWS ON THE PROSPECT OF A SYSTEM OPERATOR IN A REFORMED UPSTREAM MARKET, AND RELATED ISSUES

From CIWEM's annual conference, April 2015:

Ian Barker, Water Policy International

"It's fascinating to speculate, and quite exciting to consider opening up opportunities, but then there is the question of how you bring everyone together. Is there a case for a SO within the catchment? I get slightly worried about a single controlling mind. There may be a way through dialogue to find consensus."

Derek Meacham, Gemserv

"A balancing regime in different areas of the country is probably something we will see in time. I think you do need to have someone holding the reins. But not at a national level."

Tony Smith, CC Water

"It's too soon to say, and the question is based on a presumption of a complex market. It's too early to know that; for example, it may be that we pursue more active bulk supply arrangements." He added that from the customer point of view, the key issues would be around price and not jeopardising long term investment.

From Marketforce's Future of Utilities conference, March 2015

Steve Mogford, United Utilities

Mogford considered that water companies operating in a reformed upstream market may need to pick up the role of system operator. He said the industry effectively carries out this role at the moment because of its integrated nature. But in a market where multiple parties operated at different points of the value chain, someone would need to oversee and manage the whole picture and plan for the long term. "We would lose that integration at our peril," he observed, adding that "much relies on integrated catchment management."

Mogford remarked that it was unlikely that either Ofwat or the government would want to take on responsibility for the operation of the whole water cycle, and hence that water companies would be best placed to enhance their role and act as system operators of the future. He urged that lessons be learned from other industries that have been through similar processes: "If the value chain is to be broken up, we must learn from energy, telecoms, rail." As yet, he said, it was unclear whether water would end up structured similarly to energy, with the equivalent of generators, a national grid, distribution businesses and suppliers, or whether more integration between functions would remain.

Jean Spencer, Anglian Water

"Are there lessons from energy on upstream reform? What can we learn about security of supply? Water companies look at long term planning at the moment. We don't want to get to a position where there is no one there to do that."

From Policy Exchange Speech, March 2015

Jonson Cox, Ofwat,

In questions, Cox was asked whether there would be a role for a SO in a more fragmented market, to deliver integration and security of supply, and whether Ofwat would be the "decider" in a fragmented market. He indicated that Ofwat hadn't explored the matter in depth, but that he wouldn't necessarily jump to the SO conclusion, commenting: "We need to understand what systems and IT can do for us today. There is a lot to take advantage of in technology."

DEEP THINKING

Structural reform, customer empowerment and innovation surfaced as key topics when water leaders gathered early this month to discuss how to respond to the major challenges and opportunities facing the industry.

New water minister Rory Stewart was barely a day into the job when this month's Indepen Forum met to chew over the biggest issues facing the water sector today. The group of senior influential figures – including incumbents and new entrants, regulators and policy makers, and investors and advisors – convened to discuss how best to respond to the challenges and opportunities of growth, climate change, sustainability and the changing demands of customers. There was acknowledgement that privatisation had been a huge success – bills held down while efficiency, standards and customer service have all dramatically improved. But the focus was not on achievements to date, but rather on where we go from here. What does the future look like, and who is in the driving seat?

Less is more

Among the many views expressed was that the industry would have to change radically to be able to cope with the multitude of pressures upon it, particularly given the fact that it was crucial in current times to work within an envelope of affordability. Important factors here are:

- Customer expectations have changed beyond recognition on the back of slick retail practices from the likes of Amazon. Coming top of the SIM table is not enough as customers benchmark water suppliers against other companies they come into contact with, not other water companies.
- Resilience – particularly in light of climate change – has surfaced as a major challenge that was not envisaged at the time of privatisation.
- The industry's asset base is aged
- Population is swelling – rapidly in some areas – and putting additional strain on water resources and wastewater management.
- Vulnerable and low income customer needs are significant in scale and must be catered for. Among the many groups who need some kind of extra care are the quarter of all adults who will suffer a mental illness at some point in their lives; the one in seven who have a reading age of 11 or below; the 1.5m with dementia; and the half of all adults who don't have enough savings to cope with an unexpected £300 bill.

A new model was proposed in response, one where incumbents cut the regulated monopoly services they provide right back to the bone and open up other services to competition.

Fundamental to this would be using catchments more. Company schemes have proved that significant sums can be cut from investment programmes by working with farmers and landowners to protect water quality at source, for instance. In the future, farmers could be paid far more extensively to provide ecosystem services, ultimately saving the water customer money.

Elsewhere new entrants and companies from other sectors could perform services – even to the point of building networks for specific customer segments – where it is cheaper or better in some way than the incumbent doing this itself.

Customers in control?

A major section of the Forum's debate was devoted to how much sway customers should – or even could – hold over water policy and investment decisions. Those in favour of empowering consumers further argued the industry should ditch its historic parent/child model of engaging, interact deeply with a broad range of customers not just those who have had an issue or problem, and unquestioningly carry out customer wishes once they are established.

In particular, companies should pursue further the work that started in PR14, pinning business planning and investments to customer preferences. For PR19, customers could negotiate on price and service directly with companies as Scotland's Customer Forum did with Scottish Water for 2015-21. Ofwat could follow WICS' example in providing objective information and a steer on its thinking on key issues such as cost of capital up front – and then taking a back seat.

Others had reservations about allowing customers to call all the shots, pointing out that most customers are disengaged or disinterested (as long as their supply continues and their bills are reasonable), and that customer-led decisions run the risk of being ill-informed. The view was put forward that the company/customer relationship should be akin to the doctor/patient relationship, with companies as the experts stepping up and prescribing the best course of action.

Some practical matters were raised too: can monopoly operators really engage with customers in a meaningful way? How can customer views be truly established, given the limitations of research – even simple things like how questions are phrased can influence research outputs, as social tariff engagement for instance has shown. And if customers are to be in control, how can the government be held off from calling the shots as it has historically done?

A middle path proposed was that customer engagement takes place on two levels: with 'expert customers' such as the Consumer Council for Water and Citizens Advice providing informed interaction on big picture issues, while 'ordinary' customers are asked for views on more specific projects and investments.

There was consensus on one aspect: that it would be beneficial for companies to take a more proactive role in educating customers on water and wastewater issues, arming them with the ability to make more informed choices if called upon to do so. In particular, it was suggested that attention should be given to communicating the environmental services and benefits water bills fund, as these are currently very little known among the public.

Companies step up?

How far companies can be expected to voluntarily go the extra mile for customers was also on the agenda; to what extent they should do things because they are "right" or because customers want them, rather than because they are duty bound to do so. Most present at the Forum meeting indicated there was increasing willingness on the part of the industry to do this, with social tariffs being one example. Going forward, this spirit might manifest itself in, for example, going beyond minimum requirements on sewer flooding, or taking a more active role in drainage and wider flood management.

Innovation

The Forum discussed what the focus of water sector innovation should be. Among the suggestions put forward were:

- How to decarbonise the industry
- How to effectively change customer behaviour – for instance to use less water
- How to harness the power of social media for good – for instance, how can companies access information on the choices customers make elsewhere in their lives and use it constructively in engagement work?
- How best can the third parties that companies work collaboratively with – such as farmers and landowners – contribute to the services water companies provide?

It was acknowledged that some of the major challenges were too big for individual companies to grapple with alone and that more cross-industry collaboration would be beneficial.

Retail market ready?

Though not discussed extensively at the Forum, there was mention of the sector's ability to deliver an effective business retail market by the current deadline of April 2017. There was acknowledgement that collective readiness was required; if even one company failed to prepare adequately, there would be implications for all. It was observed that, should a change in the delivery schedule be needed, now would be a good time to put that forward before the new water minister becomes ensconced in delivering existing arrangements.

Role of the regulator

Do regulators help or hinder companies? Some Forum members indicated regulators had become too intrusive and it would be beneficial for them to step back. Others observed regulators' intent was always good, even if individual policies and decisions could be questioned, and that they should not be viewed as a hindrance but rather as just doing their jobs. A couple of recent Ofwat innovations were discussed specifically.

- **Totex**: there was broad agreement that moving away from separate capital and operating expenditure allowances was real progress and should over time reduce bills and deliver better outcomes. It was observed that totex was likely to produce winners and losers over the next few years, depending on how well companies cope with the new arrangements. Some expressed that they would like the regulator to go further and move from a totex basis to simply treating £1 as a £1.
- **Outcome Delivery Incentives:** some were strongly in favour of ODIs, hailing them as an real innovation that enabled companies to hammer home the need throughout their organisations to deliver on priority commitments – for instance, through staff rewards. Others considered ODIs well meaning, but raised the fact that they may distort priorities and result in the neglect of areas where financial rewards are not in play. It was noted that many CCGs had overtly opposed the concept of rewarding companies for outperformance, but that Ofwat had overruled that and imposed them anyway. TWR

BIG QUESTIONS FOR WATER RAISED AT JUNE'S INDEPEN FORUM

1. How far should customers drive the water agenda? How should they be empowered – through CCGs or by other means?
2. How can resilience be improved? Should companies play a greater role on flooding? What is the link between more resilient supplies and water management?
3. How can environmental standards be improved within an envelope of affordability? What role should CAP reform and catchment management play?
4. How can the sector become more efficient?
5. How can innovation be encouraged? What role will partnership working and collaboration play?
6. What is the future of financing?
7. How can vulnerable and low income customers best be looked after? Should there be greater harmonisation of offerings across the industry?

RBMP2 DECISION TIME NEARS

WWF and RSPB urge water companies to support an ambitious approach to future water quality and for agriculture to shoulder a fair share of the cost.

What should go into the second round of River Basin Management Plans (RBMPs)? With the general election out of the way, DEFRA and the Environment Agency will be pouring over responses to a consultation on the issue that ran from October 2014 to March 2015. By autumn, updated RBMPs are due with ministers along with an impact assessment on the favoured model. Final ministerial sign off will take place in December.

According to a WWF, the RSPB and the Angling Trust, the outcome ranks up there as "one of the most crucial environmental decisions of the next Parliament". At stake is the level of ambition for the water environment that will be locked in for the years ahead, together of course with what it will cost and who will pay. But it is far from a simple case of the greater the ambition the greater the cost; who bears the cost is relevant, as is what level of benefit will be derived from any given level of action.

The three environmental groups have been, and continue to, lobby for the environment secretary to be bold and commit to measures that will put us on course to get 75% of water bodies to a healthy state – in the process delivering the maximum multi-billion pound net benefit to society. In this, they would welcome the overt support of the water industry which, they argue, would shoulder a far smaller proportion of the overall cost if an ambitious route was taken.

RBMPs round 1

The concept of river basin management planning and managing the water environment in an integrated way has widespread support. According to WWF and the RSPB, RBMPs "represent a world-leading innovation, organising the management of water bodies at a natural geographical and topographical scale (ie river basins), and empowering local citizens and groups".

The first plans were published in December 2009, when only 26% of water bodies in England and Wales were classified as of 'good' status. The rest suffered from stresses that will be familiar to all those in the sector: pollution and over abstraction, aggravated by population growth and climate change, with knock-on effects for water quality, availability and management. The plan was to bring the 'good' number up to 32% by 2015.

It is difficult to track progress precisely because of various changes since 2009. For one thing, the Welsh EA has been hived off into Natural Resources Wales. For another, the classification figures used vary. On data for 2014, for instance, head of water policy at the RSPB Rob Cunningham points out that while good status under cycle one classifications stands at 23%, under cycle 2 classifications it stands at just 17%. He explains: "The lurch from 23% to 17% at 'good' should be understood in the context of the tightening of standards known to be too lax as well as a far more comprehensive monitoring network that means we now have a much better picture of overall ecological health – and it's not pretty."

However you work it, it progress since 2009 hasn't been strong despite the limited ambition. But it should be noted that the water industry (and its customers) pulled its weight in 2009-15: it has shouldered the lion's share of round 1 WRMPs costs, on top of the billions previously invested since privatisation.

RBMPs round 2

With round 2 imminent, green groups want to see a step change in the government's commitment to improving the water environment, and all the sectors responsible for its wellbeing taking their share of responsibility. However, they are a long way from optimistic. Cunningham is far from enamoured with the quality of the EA's October consultation. "The plans that have been consulted on are more a shopping list than actual plans," he says. "You can't drill down to understand what objectives are being set for which water bodies. It's extremely thin."

In a parliamentary briefing note, the groups describe progress since 2009 as "woefully inadequate" but say they have "seen few if any proposals for significant new resources or measures in the form of advice, incentive or regulation to tackle longstanding problems such as diffuse pollution".

They add: "As a result we are extremely concerned that the government intends to repackage the same ineffective suite of measures and expect a different result. We believe this is unacceptable. We call on the government and EA to implement best practice in policy development by reviewing the effectiveness of current measures and using the understanding gained about gaps and inadequacies to shape the new plans in 2015."

Particular "gaps and inadequacies" the note highlights are tackling unsustainable abstractions from sectors beyond the water industry; diffuse pollution from agriculture; and failure to meet protected area objectives.

FIVE SCENARIOS FOR FUTURE WATER QUALITY

The economic analysis section of *Water for Life and Livelihoods* – the EA's consultation on updating the 2009 river basin management plans – presents five alternative scenarios for the future management of the water environment. It also identifies four key sectors whose activities benefit from or can impact on the quality of the water environment. These sectors are: government/public sector; rural land managers; industry; and water companies.

- Scenario 1 looks at what would happen if no further measures are taken.
- Scenario 2 considers the addition of new measures but only to prevent deterioration in status and to achieve protected area objectives.
- Scenario 3 is the most ambitious, building on scenario 2 by including all technically feasible measures needed to achieve good status by 2027. No measures are ruled out on the basis of cost, affordability constraints or available funding.
- Scenario 4 builds on scenario 2 by including all measures which are technically feasible but only where the benefits justify the cost. No measures are ruled out on the basis of affordability constraints or available funding.
- Scenario 5 factors in affordability and available finance. It illustrates the scale of actions and improvements from Scenario 4 that might be achieved between 2015 and 2021 given funding constraints.

Scenario 4 v 5

The October consultation presents five scenarios for the next round of RBMPs, varying in terms of ambition, cost and who pays (see box). WWF and RSPB support scenario 4, which would get 75% of water bodies to good health by 2027 and, the EA analysis suggests, deliver a net benefit to society of £8.4bn. These benefits stem from a variety of things, from tourism and recreation to flood alleviation and more resilient water supplies.

The groups fear though that the EA's "most likely scenario" will be scenario 5. This represents the bundle of existing spending commitments and regulatory tools and is predicted to get 37% of water bodies to good health by 2021. Back in October, the EA said this would deliver a significantly smaller net benefit of £1.3bn. Cunningham though disputes even these thinner figures. "The 37% figure represents an ideal uptake of measures – not the reality we see on the ground. In addition the EA have confirmed they made a mistake in calculating the summary economic figures," he insists. "The business as usual scenario [scenario 5] will in fact cost significantly more [£3bn not the £1.1bn originally stated]. This casts a shadow of doubt over whether the supposedly cheaper option is in fact more expensive than some of the other scenarios." He adds that where cost is a major consideration, this "knocks down one of the planks of opposition to greater ambition".

Water companies might be expected to support the scenario 4 case given that under it they would proportionally shoulder half the burden they would under scenario 5 (see table 1).

This is because scenario 4 adopts the polluter pays philosophy, while scenario 5 continues the current practice of water companies (and hence water customers) taking on the lion's share of cost. WWF public affairs specialist Dominic Gogol points out that cost recovery is part and parcel of the Water Framework Directive so if the government opts for an alternative route it should "justify why it is not following polluter pays".

He believes the polluter pays principle should play a defining role in how measures required to deliver the RBMPs are distributed. WWF supports in particular attaching conditions to funds such as Single Farm Payments under the Common Agricultural Policy; and wider use of fines and penalties (that reflect environmental damages) for pollution and breaches of environmental regulation.

How optimistic is Gogol on polluter pay prospects? "It depends whether you mean technically or physically. Can we do it? Yes, the tools are available. The bigger question is: is there a will to do it? Is there appetite for a more regulated approach to agriculture?"

History suggests farming reform will be an uphill struggle. No party of any persuasion has had the stomach to tackle it. This could be made even tougher by the deregulatory stance of the current government .The environmental lobby would welcome support from the water industry, who would also benefit from the cost burden being spread more widely. Cunningham asserts that because of their catchment management work, companies like Wessex Water and South West Water have a "good understanding of how catchment management can deliver improvements cost effectively".

But he observes: "We haven't heard a strong concerted voice from the water industry on how to tackle diffuse pollution and who should pay. People [in water companies] will no doubt agree more could be done privately but will probably be scared of greater WFD ambition because they fear their customers will be left to pick up the bill if agriculture and other sectors are not made to pay their fair share." The green groups, however, urge that for society is to obtain maximum benefit, things have to change. TWR

TABLE 1: POLLUTER PAYS V STATUS QUO

Sector	Scenario 4 'polluter pays' 75% Good	Scenario 5 'currently pays' 37% Good
Government	14%	18%
Industry	9%	7%
Agriculture	41%	3%
Water companies	36%	72%

Source: WWF/RSPB/Angling Trust

TABLE 2 : COSTS, BENEFITS AND WATER QUALITY STATUS UNDER THE FIVE SCENARIOS

	2013 baseline	Scenario 1	Scenario 2	Scenario 3	Scenario 4	Scenario 5
Water bodies at good+ status	30%	19%	33%	81%	75%	37%
Total PV costs	n/a	n/a	£4.6bn	£16.1bn	£12.1bn	£3.0bn
Total PV benefits	n/a	n/a	£10.9bn	£21.1bn	£20.6bn	£5.9bn
Net present value	n/a	n/a	£6.2bn	£5bn	£8.4bn	£2.9bn
Comments:		Deterioration of water quality and negative impact on society	Significant NPV. Costs would fall most heavily on land managers.	Best water quality outcome but not best NPV. Exceeds WFD requirements	Best NPV but relatively high costs.	7% increase in good status is optimistic. Water cos would shoulder most cost.

Notes:
- % of water bodies of good or high status are by 2027 for scenarios 1-4 and by 2021 for scenario 5.
- Costs and benefits for scenarios 2-4 are for 37 years (2x6-yr WFD planning cycles plus 25yrs). Scenario 5 costs and benefits are for 6 years only (2016-21)
- Scenario 5 figures are corrected; the original consultation showed: total PV cost of £1.1bn; total PV benefits of £2.4bn; and NPV of £1.3bn.

Source: EA

Under scenario 5, the water industry (funded by their customers) would continue to make the largest investment and the fastest progress towards mitigating the damage their activities have on the water environment. Under scenario 4, costs would be fall marginally more heavily on agriculture.

NORTH

Roger Darlington, chair of South East Water's new Customer Panel, is disappointed that only companies in southern England have CCG successor groups up an running for the start of AMP6. But he relishes his new role monitoring how well South East lives up to its PR14 promises.

SOUTH DIVIDE

Ofwat was intentionally non-prescriptive when it first introduced the Customer Challenge Group (CCG) concept during PR14. Companies were free to decide how to structure and populate their groups and who should chair them. Once established, the groups were free to decide how to manage their arrangements and how to present their reports on company business plans (and subsequent submissions). Even a cursory look through the reports CCGs submitted to Ofwat in December 2013 shows considerable variety.

While formal learning from the CCG process is yet to come, variety looks set to characterise the CCG successor groups companies are electing to establish (most have said they intend to put a new body in place for AMP6, to challenge them routinely rather than just as part of the price review process, and to monitor their delivery of business plan commitments). There is an initial split between those forging on immediately with successor bodies and those who are opting to wait a while to get their new groups off the ground.

Six water companies, all based in southern England, fall into the former camp: South East, Sutton and East Surrey, Affinity and Portsmouth of the water-only companies, and Southern and Thames of the water and sewerage companies. All other companies are expected to get their groups up and running in autumn or after; some not until into 2016.

Last issue, *The Water Report* spoke at length with Anna Bradley, chair of Southern Water's new Customer Advisory Panel, about Southern's arrangements. This month, Roger Darlington who chaired South East Water's CCG and has broad experience of consumer representation across a number of sectors, shares his observations about successor group progress to date. He also specifically discusses details about South East's new Customer Panel, which he also chairs.

"Disappointing" delay

To begin with, Darlington is unimpressed by slow progress beyond the southern six. He argues that, if the primary purpose of the successor groups is to monitor how companies are delivering against the promises they signed up to, then the time to start is now. "For monitoring, the first two years are critical because after that, it will be harder to make changes. And ODIs [Outcome Delivery Incentives] are new and this is the time to see if they are working." Groups not planning to start until next year will, says Darlington, "lose a year; there will be no close monitoring of company performance for that period". He observes: "To get these groups up and running and to make them effective takes time. You have to appoint the chair, choose the members and then they have to build up a level of knowledge and develop relationships to work in partnership."

Darlington believes that even the six early starters – and ultimately their customers – will suffer from the reticence of other companies to act swiftly. "The delay is very disappointing and actually from our point of view worrying. There would be great benefit in all the groups working together and sharing insight. I don't think the cleft between CC Water-chaired CCGs and non CC Water-chaired CCGs in PR14 served customers well. I would

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like to cooperate nationwide as soon as possible, but obviously can only work with those who are already there."

He adds that Ofwat is very unlikely to step in and require action until PR19 preparations begin in earnest – and possibly not even then. "In the spirit of empowering companies, I think Ofwat's line will be 'we'll leave this to you,'" he says. "There will be a formal review of PR14 including of the CCGs and it is likely recommendations will be made. But these are likely to be in relation to the price review and business planning rather than the monitoring role. I also doubt that the recommendations will amount to a mandate. Even at PR19, it is possible there will be no mandate from Ofwat for CCG-type groups, especially if most companies have voluntary groups in place by then anyway."

Mix of six

Looking at the six groups in the south that are active, Darlington observes that they are "looking quite different" from each other, although there are of course common threads. A relatively trivial point is that the groups have chosen a variety of names. Darlington fills in the details: Thames and Portsmouth are planning to stick with 'Customer Challenge Group' but the other four have chosen "to signal it is a different body, not set up at the behest of the regulator, whose job is not to report to the regulator but to companies and customers; whose job is not to critique the production of a plan but to monitor the implementation of it" (see box, CCG successor groups – more than a name change). South East Water has opted for 'Customer Panel'; Affinity for 'Customer Scrutiny Group'; Sutton and East Surrey for 'Customer Scrutiny Panel' and Southern for 'Customer Advisory Panel' – all variations on a similar theme.

> **All of the six groups have chosen to reappoint the person who chaired their CCG to chair their successor group but there is variety in the tenure of these individuals and in their medium term intentions.**

All of the six groups have chosen to reappoint the person who chaired their CCG to chair their successor group but there is variety in the tenure of these individuals and in their medium term intentions. Some companies clearly have an eye to the possible need to refresh their groups ahead of PR19. The common thread though is that all six southern companies will have an independent, competitively appointed chair in place within the year.

As we heard last issue, Anna Bradley has a three year contract but she confirmed there was a working assumption that Southern's Customer Advisory Panel would run for the full AMP6 period. The three year term is to facilitate flexibility, should the group need to adapt to participate in PR19.

Darlington himself, and Robin Dahlberg who chairs Affinity's Customer Scrutiny Group, have two year contracts. Darlington thinks it unlikely he will stay beyond 2017: "I want to see that the current plan is working, but not necessarily to go through another price review," he explains. "I haven't completely ruled out staying on, but I would have done five years by then. Two three-year terms are normal for positions like this in other sectors. Limited terms aid independence and help keep things fresh."

At Portsmouth, Darlington explains that chair David Guest has a one year contract to cover the transition period but that the company is then likely to advertise and competitively appoint a chair for 2016 onwards. Guest was selected for the PR14 CCG on the back of his strong local profile as a councillor, but according to Darlington, Portsmouth sees the benefit of a competitive appointment going forward. It is a similar story at Sutton and East Surrey, says South East Water's customer champion, where chair Jean Venables is expected to continue for 2015 and then hand over to someone appointed competitively.

Darlington says Thames intends to advertise for a new chair by early summer with a view to the appointment starting in September. CCG chair David Bland has stayed on to help manage that process.

In terms of membership, there are three key issues that differentiate the six successor groups: their size; the extent to which the company has taken the opportunity to recruit new members; and whether or not they have elected to continue with the CCG practice of including quality regulators (the Environment Agency, the Drinking Water Inspectorate and Natural England) as part of the group.

Darlington reports that both Thames and Portsmouth have chosen large memberships and not to fundamentally change the arrangements they had in place for PR14. South East, Southern and Affinity have smaller memberships (of around 8-12) and have taken the opportunity for a significant refresh. First off the mark Affinity, Darlington observes, has taken care to appoint members from each of its three geographical areas. Sutton and East Surrey has not finalised its group membership yet, but Darlington says it is expected to follow the smaller model selected by South East, Southern and Affinity.

The six companies have taken varying approaches to the quality regulator issue, with South East and Southern, for instance, opting to exclude (but to continue to engage externally with) these former CCG members. Others have kept them on.

In terms of how often the groups will meet, this ranges from monthly at Thames; through bi-monthly at Southern; to quarterly at the rest.

South East Water's Customer Panel

Darlington elaborates on South East Water's choices and the reasons for them. "Myself and three others from the CCG are staying on, but we have seven new members who are drawn overwhelmingly from actual customers. This reflects a move away from a regulatory focus to a customer focus."

Among the members are two CC Water people (regional manager Karen Gibbs and the Local Customer Advocate assigned to South East Water Penny Shepherd); one business customer representative (from the Kent Invicta Chamber of Commerce); a local Age UK representative; a social housing representative (from West Kent Housing Association); a local authority representative; and, interestingly, three "ordinary" customers – chosen because of their ability and willingness to engage in line with group requirements.

Darlington comments: "We've reshaped it so the focus is on genuine customers, and particularly residential customers as businesses will have choice after 2017." He adds that the group will draw heavily on data produced by stakeholders including CC Water and Ofwat to extend its reach beyond the experience and expertise of its immediate members.

On group size, he explains: "We were always one of the smallest groups and I wanted to keep it that way. It's broad enough that we aren't dominated by any individual, but not so broad that it's unwieldily or that people feel comfortable not showing up to meetings. Also I wanted everyone to be assured that their voice would be heard and not lost in the crowd."

The three quality regulators have not been invited to join the Customer Panel as members, although the Environment Agency has been granted a standing invitation to attend meetings. "On top of that, we have an agenda item once a year on water quality and the water environment specifically, when we will invite the regulators in in an advisory capacity," Darlington adds. "Again this reflects the fact that this is not a regulatory process, and it also recognises that these regulators struggled to service all the CCGs."

The Customer Panel will meet quarterly – meetings have been scheduled for the next full financial year – and the main agenda item will be to study the quarterly performance data South East Water publishes. Members who attend outside of their professional duties (so, for instance, the ordinary customers and those such as the Citizens Advice representative who effectively attends the group on their own time) will receive an attendance allowance from South East Water. Darlington feels strongly that this is the right thing to do following his CCG experience: "A number of us were concerned that the CCGs were much more demanding of time and intellect that we had expected, and it was hard for members at times to stay on top of everything.

"There is a strong case for paying people an attendance allowance, which they only get if they attend a meeting. It is normal practice across the consumer representation field and because we are talking about fairly small amounts there is no risk of it affecting members' independence. I think you also get a better quality person this way, and better attendance."

The Customer Panel will report annually at the end of each year to the South East Water board, and to South East's 2.1 million customers most likely through online channels. TWR

CCG SUCCESSOR GROUPS – MORE THAN A NAME CHANGE

In many respects, the customer groups currently being put in place are similar to the CCGs of PR14: they are located under companies' wings and are intended to provide independent challenge. Some members will be common to both groups. But there are also a number of important differences to bear in mind:

- **Companies call the shots:** The groups are not convened by Ofwat; companies are voluntarily putting them in place. They do not therefore report to the regulator but to company boards and customers. The industry earned high praise for its engagement with, and support for, CCGs in PR14. While the new groups don't have regulatory underpinning, given companies are voluntarily establishing them, management teams can be expected to respect their recommendations. On a practical level, without having to react to Ofwat decisions and publications, the groups should be able to schedule meetings and document circulation more evenly, alleviating the workload peaks that came to characterise the CCGs.
- **Monitoring function:** The main function of the groups is to monitor company delivery of business plan commitments. This is a more practical role than the CCG job, which was to challenge proposed outcomes and performance commitments. Darlington says: "Arguably, the groups have got more traction now; they are measuring what is actually happening not commenting on a plan. It's more meaningful in a way."
- **Reformed boards:** Darlington believes Ofwat's good governance guidelines and the consequent board changes that have taken place across the industry could bring a new dynamic to the way companies interact with their CCG successor groups. "As a broad theme, water company boards have become more similar to boards in competitive sectors. There are more independent members and more people are being brought in from outside the sector. There are some impressive figures coming in. Boards are becoming less introverted, and this could introduce an interesting dynamic for the successor CCG groups." South East Water has a new chair in former United Utilities non-executive director Nick Salmon, who has recently replaced retiring Gordon Maxwell.
- **Market reform:** The fact that business customers will be able to switch supplier after April 2017 will have implications for CCG successor groups. Arguably business customers can afford to have a lower profile on the groups, seeing as the ultimate sanction of voting with their feet will be open to them. Meanwhile, water company preparations for market opening are also likely to affect how companies interact with their in-house consumer groups. Darlington observes that – partly as a result of the different role his new group will perform, and partly as a result of South East's repositioning in light of market opening – the company's regular attendees to customer group meetings will change. The CCG was regularly attended by two people from South East's regulatory team and one from the communications team. Customer Panel meetings will be attended by the director of customer services and a representative from each the retail and wholesale parts of the business.

MORE THE MERRIER

Darlington is of the opinion that a multiplicity of voices speaking up for the consumer – CC Water, the CCG successor groups and, ideally, a standing consumer advisory panel to challenge Ofwat on a day-to-day basis – is a good thing. He mulls that the fact that the pollsters got the general election result last month so wrong has interesting implications for water research and how the customer interest is ascertained. "We rely heavily on research, we relied on it as the basis of business planning, but the election polling shows it isn't always as straightforward as asking people what they will do or what they want. We've already seen huge variety of opinion on social tariffs, for instance, which suggests that things like how questions are phrased is of huge importance.

"This raises a fundamental question: that when we talk about the 'consumer interest' – or 'citizen interest' if you are talking about things like clean beaches – how do we really determine exactly what that interest is? Of course you have to gather evidence where you can, but you will also have to exercise judgement.

"When you exercise judgement, it is important to be as transparent as possible about how you have reached the view you have, so people can see what your judgements are based on. Along with transparency, I think a multiplicity of voices is helpful. The more voices there are, the more insight and influence there is likely to be."

FIRMS TOLD TO MAKE A CASE FOR MERGERS

Companies are invited to propose remedies to offset comparator loss under the new merger regime

In line with its strategy of encouraging water firms to rely less on regulatory diktat and more on their own wits, Ofwat's future mergers consultation published late last month puts the onus squarely on companies to make the case for consolidation if they want to pursue it. In particular, under incoming rules companies will for the first time be invited to propose measures upfront to remedy or offset any detriment arising from a desired deal.

The consultation follows changes made to the special merger regime by the Water Act 2014. Parliament's intention was to oil the wheels of notoriously difficult water tie-ups by reducing the number being referred to in-depth "Phase 2" investigations at the Competition and Markets Authority (Pennon Group's April £100m purchase of Bournemouth Water moved to this stage on 8 June). The legislation does this essentially by expanding options for the part of the process that precedes the full six-month inquiry. On top of the existing tests (based primarily on the turnover of the target and would-be acquirer), the new regime enables the CMA to decide whether a deal needs to be referred on to Phase 2, based on the following three questions:

- is the merger likely to prejudice Ofwat's ability to make comparisons?
- would relevant customer benefits outweigh this prejudice?
- has the company offered appropriate undertakings in lieu (UIL) to remedy, mitigate or prevent the prejudicial effect on Ofwat's ability to make comparisons?

An extensive role is earmarked for Ofwat to feed into the CMA's decision-making process at Phase 1, and it is how precisely it intends to do this that the regulator's May consultation sets out. Three stages are envisaged in Phase 1 (see box) and the formal timescale looks like it will be tight. Merger parties will be required to submit a "merger impact submission" at the start of the phase, addressing each of the three questions above.

For companies wishing to merge, the message is loud and clear: the quality of that impact submission will be crucial, and ahead of that, the more information and discussion that can be had in the pre-notification period before the clock starts ticking, the better. The regulator says: "In assessing the impacts of the merger on our ability to make comparisons and the customer benefits, the greatest weight will be placed on merger party assessments which are complete, robust, certain, clear, independently assured and which provide evidence of customer support."

Inevitably, Ofwat expects company evidence to fall into line with its own thinking on these issues, which it sets out in the consultation through both high level principles and, crucially, a "statement of methods". In essence, the high level principles restate the value Ofwat has historically attached to comparators, citing them as essential for a whole host of regulatory functions including cost modelling in price reviews, Outcome Delivery Incentive setting and the Service Incentive Mechanism. But they also acknowledge that mergers can have benefits and that the two factors need to be weighed up on merit on a case by case basis.

The statement of methods sets out the criteria Ofwat will use to assess the impact of the proposed merger on its ability to make comparisons and the weighting applied to those criteria (see box – Ofwat's statement of methods) Companies wishing to merge will need to scrutinise this criteria and build their case around it. The consultation points out: "Merger party submissions that comply with our statement of methods are likely to have the most weight."

The new regime clearly won't be a walk in the park for companies. WASC/WASC merger prospects remain remote, but a poor performing WOC should – rightfully if it drives performance improvement –have less trouble. But enabling companies upfront in the process to have an extensive say and, importantly, to be able to propose rebalancing initiatives should open up options – for both traditional acquisitions and potentially more innovative structures. TWR

For richer, for poorer: the CMA will weigh customer gains against detriment to Ofwat's ability to make comparisons

THE THREE MAIN STAGES OF THE NEW PHASE 1 PROCESS

- **Pre-notification:** in this period, the merger parties will need to develop a merger impact assessment. Prior to formally submitting a merger notification to the CMA, merger parties are encouraged to discuss the proposed merger with both Ofwat and the CMA. There is no formal time limit on these discussions, so merger parties are encouraged to open dialogue at the earliest opportunity.
- **Phase 1 investigation:** the CMA will have up to 40 working days from the receipt of a complete merger notice to conduct the Phase 1 investigation. During this period the CMA will consider whether the merger will prejudice Ofwat's ability to make comparisons and where relevant, whether customer benefits arising from the merger would outweigh this prejudice. Ofwat must provide its advice in accordance with its statement of methods. If merger parties have raised UILs by this stage of the process, the CMA must also consider Ofwat's opinion on the effect of those UILs.
- **Consideration of UILs of a Phase 2 reference:** if the CMA concludes that a merger prejudices Ofwat's ability to make comparisons between water companies and that this prejudice is not outweighed by relevant customer benefits, the merger parties will have the opportunity to propose UILs to offset that prejudice. If UILs are proposed the CMA must request and consider Ofwat's opinion on these undertakings before determining whether the UILs offered are sufficient to offset the prejudice.

OFWAT'S STATEMENT OF METHODS

The criteria Ofwat will use to assess whether a merger would prejudice its ability to make comparisons are:

- The extent to which the merger involves overlaps in functions. Where it does not – for example were a water only company to take over another company's sewerage functions – no prejudice would be found.
- Whether the merger involves the loss of an independent comparator. For example, if the company taken over is already under cross ownership and control, the regulator's ability to make comparisons may not be prejudiced.
- The extent to which the merger would change benchmarks – a high performing company would be a bigger loss than a mid or poor performer.
- The number and quality of independent comparators that remain – with 18 water comparators, but only ten wastewater comparators, the latter would be a bigger loss.
- The extent to which the company had important similarities to a small number of the remaining companies. For example, if a company with high population density was lost, it might be more difficult to separate out the impact of this factor on driving cost and outcome performance.
- The extent to which the company had important differences from others – for example, a firm exhibiting best practice on customer engagement or innovation that could be used to raise standards across the sector.
- The extent to which Ofwat could amend its regulatory approach to offset the loss of a comparator.

The regulator advises: "The assessment of the first two criteria will be based on yes/no response… If the answer to either question is no, then we are unlikely to take the view that the merger would cause prejudice to our ability to make comparisons. If this is the case then we would not proceed with the assessment against the other criteria and would provide our opinion to the CMA on that basis.

"We will apply equal weights to each of the other criteria. Where possible we will monetise impacts against these criteria, that is convert impacts into a £m impact."

The criteria Ofwat will use to assess relevant customer benefits are:

- Are there relevant customer benefits in terms of lower prices, higher quality or greater choice or greater innovation in relation to such services that will accrue to customers of merger parties?
- How likely or certain are the benefits to be achieved?
- Are the benefits merger specific?
- Are benefits likely to accrue in a reasonable period of time?
- Are benefits likely to be sustained?

As with the impacts on comparators, Ofwat will weight impacts against the criteria, where possible based on their monetised impacts. Given the option of a Phase 2 investigation, the regulator notes that it would "need compelling evidence to recommend to the CMA that in our view customer benefits outweigh the likely prejudice from the impact of the merger on our ability to make comparisons".

Undertakings in lieu

Likewise, Ofwat would need to be sure UILs adequately remedied any detriment caused by comparator loss without a Phase 2 inquiry. It said: "We consider that UILs are only appropriate where there are clear cut remedies proposed to address the prejudice caused by the merger."

It offers as examples of potentially acceptable UILs:

- **Divesture** – for example the sale of a non-contiguous part of the water company, which could create an additional independent comparator.
- **Partial divestures** – for example a reduction in the equity stake and therefore the degree of control, which in some circumstances could create management independence and restore the ability to make comparisons.
- **Separate administration** – for example an undertaking to maintain or create separate management, accounting or reporting arrangements. "This could include, for example, offering to create a separate retail company, or separate management of water resources and networks."
- **Amending licences**, for example the creation of modular licences for separate services within the merged entity.

IN BRUSSELS THIS MONTH: DWD REVIEW, WFD COSTS AND THE CIRCULAR ECONOMY

Although we only seem to hear the European Commission talking about the need for jobs and growth in Europe, there is still plenty of policy and legislative work going on relating to water that we need to follow closely in the UK.

One of the most significant right now is the Commission's review of the Drinking Water Directive (DWD). The review was not prompted by any technical or scientific reasons, and instead was part of the Commission's response to the Right 2 Water campaign, which amongst other things called for an end to liberalisation of the EU water sector.

There is agreement amongst water providers and policy makers that the DWD is one of the better pieces of EU legislation. It is clear about its intended outcomes and indeed has led to these outcomes being achieved. The quality of and access to drinking water in Europe has vastly improved since the DWD was approved.

However, because of threats to drinking water quality, including extra demand from a growing European population, the impacts of climate change and the emergence of new threats like micro-pollutants, it is actually a good time to look at the DWD again.

The Directive sets out essential quality standards at EU level and microbiological, chemical and indicator parameters must be monitored and tested regularly. Stakeholders and experts from across the EU, including Water UK and the DWI, met recently to discuss the DWD and agreed it is time to adapt the parameters to emerging challenges.

Another interesting issue which came up was that of materials in contact with drinking water, which is a growing concern given the increased opening to products from outside the EU. It will be interesting to see how the Commission deals with this. At the moment, the Commission has quite rightly said to water providers and others 'give us data and evidence that highlight the scale of this problem and then we will take appropriate action'.

The next steps for the DWD are that the Commission will continue to take evidence and carry out evaluation of the existing directive, before moving on to carrying out a full impact assessment for a revision of the directive. We should find out more in September.

Neil Dhot is secretary general delegate at EurEau, the European Federation of National Associations of Water Services. Neil will be providing an update from Brussels each month.

One out all out

Moving to wastewater, EurEau's wastewater experts met recently and during a discussion about the Water Framework Directive, it was encouraging to hear almost all of them agree the 'one out all out' principle is leading to the wrong outcomes and needs to be changed.

UK water companies and do not believe the current 'one out, all out' approach to the status of water bodies promotes the best and most efficient use of investment for environmental outcomes. For example, it might be better to spend £1m to improve the quality of five rivers even if all the status boxes cannot be ticked, than investing that £1m to raise the status of just one river from good to high.

The Commission recently kicked off discussion about the Water Framework Directive, and perhaps now wished it hadn't. The view from both public and private water providers across the EU is that there is simply not enough money to meet the targets set in the WFD, either now or in the future. We now wait to see how the Commission will respond.

Reuse incentives

Finally, staying with wastewater, EU water providers are continuing to push for the inclusion of water in the Commission's new Circular Economy package. The original proposal was encouraging a shift towards a more circular economy which relies on "reuse, high quality recycling and a limited use of primary raw materials". However it was scrapped recently after being accused of not being ambitious enough.

In the UK, we know that there are many opportunities from wastewater, including recovery of much needed nutrients for agriculture like phosphorus, recovery of gas which can be put into energy networks, and to treat and reuse water much more. These opportunities will be even more significant as markets open in England.

So along with European water providers, we are calling on the Commission to unlock the opportunities in wastewater across the EU through a mixture of legislation and incentives to create markets across the EU, as part of the circular economy package. TWR

Minister and shadow in place at last

Penrith and The Border MP Rory Stewart was confirmed as the new water minister at the start of June, almost a month after May's Conservative election victory.

Stewart's impressive and varied experience has grabbed the industry's interest. Along with a brief spell as an infantry officer in the Black Watch, he has been in the diplomatic service, served as deputy governor of two Iraqi provinces, taught at Harvard University and run a charity in Afghanistan. In 2000-02, he walked 6000 miles across Asia.

Stewart's ministerial responsibilities include: natural environment; floods and water; resource and environmental management; and rural affairs. He also has lead responsibility for the Environment Agency and Natural England.

With the exception of his role as treasurer of the All Party Parliamentary Group on Upland Farming, his Westminster career to date has had little connection with water. Most recently, from May 2014, he chaired the Defence Select Committee. He is rumoured to have taken early interest in upstream and catchment issues.

The water team at DEFRA remains under the directorship of Sarah Hendry following Sonia Phippard's recent promotion. Stewart joins the department at a difficult time: chancellor George Osborne has told DEFRA to make £83m of savings this year.

MP for Brent North Barry Gardiner has replaced Angela Smith as shadow water minister. In parliament since 1997, Gardiner has lots of experience relevant to the role. This includes stints as shadow minister for the natural environment and as parliamentary under secretary of state at DEFRA. He is also a familiar face on the EFRA Committee.

Parliamentary committees will return in July. The EFRA Committee will have a Conservative chair, with Labour in the hot seat at the Environmental Audit Committee. A ballot for the jobs was due to take place on 17 June, after The Water Report went to press.

Hydro Nation Innovation Service launched

The Scottish Government gave a boost to its international water strategy last month with the launch of a Hydro Nation Water Innovation Service.

The service will help SMEs turn research and prototypes into tangible opportunities in the global market by supporting testing and validation. Working closely with the enterprise agencies, it will also support exports, inward investment and knowledge sharing.

A three year contract to deliver the Innovation Service has been awarded to a partnership of WRc, infrastructure services firm AECOM, and UK Water. They will work collaboratively with Scottish Water, the Scottish Government, SEPA and academic institutions.

The Hydro Nation Strategy was launched in 2012, and is designed to deliver economic growth for Scotland through maximising the economic benefits of the country's water resources.

| Scottish Water International has won a new deal to provide advice and support to Adelaide-based SA Water.

NEWS IN BRIEF

River banked: the European Investment Bank has agreed a new £530m long term loan to support Severn Trent's £6.2bn five year investment programme – one of the largest ever loans to the sector.

Haven chosen: Thames Water has signed a five-year £500m deal with Haven Power. Haven will supply electricity from the biomass-fired Drax plant, taking Thames to 100% renewables-supplied.

Seeing the Future: The SBWWI has rebranded as the Future Water Association.

Trade up: SSE Water, which has 20+ inset appointments, has joined Water UK.

You are being served: House of Fraser stores in Oxford Street, Manchester and Birmingham have switched to Business Stream under a three-year deal which will also see the Scottish retailer install AMRs in other English stores.

Full water devolution is a strategic priority for Wales

The Welsh Government will pursue the devolution of all water and sewerage matters to Wales as part of a new national water strategy published last month.

Launching the document, minister for natural resources Carl Sargeant said: "We need to ensure that we have the appropriate tools and powers to deliver our strategy's objectives. We will therefore continue to pursue the devolution of all water and sewerage matters in Wales. This will, as the Silk Commission confirms, ensure that the interests of the people of Wales are better served in future."

The Water Strategy for Wales sets out the Welsh Government's wide ranging vision on how water should be used to support communities, businesses and biodiversity. It adopts a more integrated approach to the management of water in line with the Natural Resources Management policy and proposals in the Environment (Wales) Bill. A key theme is that Wales' long-term economic prosperity must go hand-in-hand with the health and resilience of the water environment, not be at its expense.

The strategy identifies six policy priorities for the period 2015 and 2018. These are:

- Developing an area based approach to natural resource management.
- Ensuring access to fair and affordable water and sewerage services.
- Devolution of all matters relating to water and sewerage and the removal of the unilateral of power of the UK government to intervene in respect of water resources in Wales.
- A more focused approach to sewerage and drainage management and development and implementation of legislation to support sustainable drainage solutions.
- Reform of the abstraction license system in Wales to ensure sustainable management of our water resources now and in the future.
- Review and where appropriate change current practices and regulatory approaches to tackle diffuse pollution.

The strategy includes an action plan detailing short term (up to 2020), medium term (2020-25) and long term (beyond 2025) actions. In the short term these actions include: bringing exempt abstractions into the licensing system; considering options to support the development of Payments for Ecosystem Services markets; monitoring the effectiveness of social tariffs and researching how best to address water poverty; looking at options to implement Schedule 3 of the Flood and Water Management Act 2010, which requires new developments to include SUDS features that comply with national standards; and undertaking a detailed assessment of the issues that will need to be addressed to move towards a new constitutional settlement.

Editor's note: The Water Report will be covering the Water Strategy for Wales in detail in a subsequent issue.

Ruling sets stage for £100m+ fines

A Court of Appeal ruling in a pollution case involving Thames Water could open the door to enormous fines for large water companies, according to law firm Herbert Smith Freehills.

Thames unsuccessfully appealed against a £250,000 fine for allowing untreated sewage to pass into a National Trust nature reserve waterway in 2012.

The case was the first at the court in which new sentencing guidelines for environmental offences were applied. Essentially these offer a matrix-style mechanism for calculating fines according to three key factors: the level of harm caused, the culpability of the offender and the size of the offender by turnover.

The rules pin down fine thresholds for four categories of company, from micro to large businesses. For the fifth category of "very large organisations" whose "turnover very greatly exceeds £50m" this mechanistic approach is not set in stone.

The recorder in the original case attempted to extend the guidelines' prescriptive fine approach to the "very large company" Thames. "However, the Court of Appeal rejected this approach and instead endorsed a much more broad-brush principles-based approach that leaves the courts far greater flexibility to set much higher fines in the most serious cases," Herbert Smith Freehills said.

The level of Thames' fine reflects its low level culpability ("negligence") and the lower harm level of the pollution caused (Category 3). But according to Herbert Smith Freehills: "The Court went on to indicate that for the most serious environmental offences it would endorse levels of fines far above anything that has been imposed previously … In the most serious cases (where Category 1 harm has been caused deliberately)", the offence may result in fines equal to up to 100% of the offender's pre-tax profit for the relevant year 'even if this results in fines in excess of £100 million."

Even *Better Connected*

Water UK has published details of new improved levels of service that the industry will provide to developers, following voluntary agreement by water companies.

The standards cover company performance on a broad range of activities including responding to initial enquiries, providing designs and quotations, construction and connection, and dealing with legal agreements. Water UK has coordinated the work and will publish performance data on its website quarterly.

Draft levels of service were first published in the government's *Better Connected* report in December 2014. Companies and Water UK have since consulted with developers to ensure the service commitments reflect the issues that are important to them.

Ofwat's senior director, customers and casework, Richard Khaldi commented: "The commitment that companies will regularly report their performance will not only improve transparency, but encourage those companies lagging behind to catch up. It will also help us identify where and how we focus our efforts to drive further benefits for customers."

Water UK chief executive Pamela Taylor said: "These standards, which are part of a broader programme of work we are undertaking in this area, demonstrate that water companies are committed to providing transparency to their developer customers about their performance and to driving improvements in service levels."

FINANCIAL RESULTS 2014-15

Water companies were publishing their financial results for the year ended 31 March 2015 as *The Water Report* was going to press this month. We will review the results collectively in our next edition to get a complete picture.

OPEN WATER TRANSITION UPDATE

When last month's *The Water Report* went to press (mid May), Open Water had just published the third market architecture plan and we were told responsibility for market delivery would transfer on 31 May from Open Water Markets Limited (OWML) fronted by WICS chief executive Alan Sutherland, to industry-led Market Operator Services Limited (MOSL) and Ofwat.

Sutherland departed as programme leader on schedule and overall programme leadership responsibility transferred to Ofwat, with Adam Cooper named as the "senior responsible owner". But it is now mid June and the full transition from OWML to Ofwat and MOSL hasn't taken place yet. Companies are understandably concerned about the uncertainty, particularly because the tight timetable to April 2017 means a smooth transition is critical and momentum cannot be lost.

In a letter published on 28 May, OWML chairman Peter Bucks confirmed that the handover would be phased and was not expected to be completed until late July. Here, Bucks sets out for *The Water Report* the context to the handover arrangements and an update on the plan.

Briefing by OWML chairman Peter Bucks on the Open Water transition arrangements:

In July 2014, Ofwat announced that it would take over all responsibility for the programme from OWML with effect from a future date, then expected to be 31 December 2014. This decision followed confirmation from Her Majesty's Treasury that OWML would be classified as a public body for purposes of national statistics and government accounts. This chiefly reflected the facts that OWML was to be funded out of licence fees and that its regulator members held special rights in terms of the articles of association, including a right of veto over certain matters. In consequence of such public body classification, Ofwat would be accountable to Parliament for OWML's use of resources and OWML would be subject to public expenditure controls.

In October 2014, Ofwat entered into discussions with a view to agreeing arrangements with WICS for the purpose of implementing the programme following the transfer of responsibility from OWML. For a variety of reasons, it proved not possible to conclude these arrangements and in February 2015, Ofwat announced that it:

- had terminated its discussions with WICS
- had asked the directors of OWML to continue to carry forward the programme for a further period at least until publication of the third iteration of the Market Architecture Plan in May 2015
- intended responsibility for procurement of the central market systems required for retail market opening, and potentially other programme activities, to be transferred to Market Operator Services Limited (MOSL), a private sector company formed for this purpose on 23 October 2014 by Anglian Water, Northumbrian Water and United Utilities, rather than to Ofwat, and in due course potentially to designate MOSL as the market operator
- would assume overall responsibility for the programme and take over the other programme activities itself
- would shortly appoint a senior director to its staff to take over the role of programme director
- would invite tenders from commercial providers to act as its delivery partner for the programme.

Since then, OWML has continued to carry the programme forward in accordance with an Integrated Programme Plan agreed by the Retail Market Opening Management Group convened by DEFRA comprising representatives of DEFRA, OWML, the regulators, and market participants. In parallel, under OWML's chairmanship, a Transition Oversight Group comprising representatives of DEFRA, OWML, MOSL and Ofwat has been overseeing development of the detailed plan for the transfer of OWML's responsibilities in accordance with the allocation of responsibilities and accountabilities announced by Ofwat on May 21 2015 and to secure the agreement of all relevant parties to the various steps that need to be taken to implement the plan.

This work has now been, or shortly will be, concluded and all the parties are now taking the necessary steps to implement the agreed transition plan. It is expected by all the parties that this will enable the work of the programme to be carried forward effectively and efficiently in accordance with the Integrated Programme Plan without any loss of momentum or continuity.

It is proposed to transfer all of OWML's programme responsibilities by stages over the period to late July 2015. Certain responsibilities, including principally responsibility for the initial work on procuring the central market systems, have already been assumed by MOSL, working in conjunction with OWML's Procurement and Market Operator and Market Assurance team.

To complete the transfer process, OWML will transfer responsibility for finalising and base-lining the market documents, systems procurement, establishing the market operator, and ensuring market readiness and company engagement to MOSL and for programme management coordination and engagement, customer engagement and establishment of the interim codes panel to Ofwat, and will terminate all its contracts and other arrangements for the provision of programme personnel and consultancy services. Following completion of the transfers, OWML will cease to trade and be wound up. TWR

ALL ABOUT THAT BASE?

What will the Baseline Review show about prospects for successful retail market delivery? And what is the latest on roles, responsibilities and readiness?

As chairman Peter Bucks sets out on page 23, Open Water Markets Limited will remain responsible for aspects of the Open Water programme for another couple of months. The full handover to Ofwat and Market Operator Services Limited (MOSL) did not take place at the end of May as was expected up until a week or so before that date. The transition arrangements have been updated, and plans are now in place to complete the handover by the end of July.

In itself, this short delay shouldn't be that problematic. Better to transfer responsibility a little later than planned and smoothly than on time and with difficulty.

What may be more significant to programme delivery though is why Open Water didn't transition to plan. There has been no official explanation, but the most probable cause is that Ofwat and/or MOSL needed additional time to ready themselves to take over. Ready in this context includes being appropriately structured, funded and resourced to ensure a smooth transition and no loss of momentum on progress.

Logically we might conclude that the Baseline Review which took place to coincide with the scheduled handover at the end of May may have thrown up some issues. Very similar to the better known Gateway Review process, the Baseline Review was a fast turn around, independent, peer review to highlight risks and issues which if not addressed would threaten successful delivery. Key stakeholders and programme personnel have been interviewed and key documents reviewed. A report has gone to Ofwat as owner of the programme (overall programme leadership responsibility did transfer to Ofwat on 31 May, with director Adam Cooper named as the "senior responsible owner").

At the time of writing, the regulator was working through a response to the report with the other delivery parties. Both the report and the response will go to the DEFRA-chaired cross party programme governance body the Retail Market Opening Management Group before they are finalised and hopefully published later this month.

The Baseline Review is expected to follow the Gateway process in issuing a traffic light-based delivery confidence rating, as detailed in the diagram. Clearly an amber-red or red rating would be serious; typically this would trigger an escalation and enhanced notification process. Amber would be the minimum acceptable rating at this stage, indicating successful delivery is in reach but needs to be pulled out of the bag. Obviously green or amber-green would be highly desirable.

Roles and responsibilities

We now have clarity on who will perform what roles precisely once OWML is wound up. Last month Ofwat published *Roles, responsibilities and governance of the Open Water programme and transition post May 2015*. This envisages the following division of labour:

- **Ofwat:** will take over programme management, customer engagement and the establishment of an interim codes panel. It will also retain responsibility for the matters allocated to it already, including charging, licensing and developing new Guaranteed Service Standards and deemed contracts for non-household customers.

- **MOSL:** will take on finalising market documents and continue its work on central market systems procurement, build and testing. It will also take responsibility for MO establishment and company engagement and readiness.

In terms of their readiness to take on their new roles and responsibilities, MOSL is understood to be making good progress under the chairmanship of United Utilities chief executive Steve Mogford, and programme leader Tim Burfoot. MOSL has confirmed central systems procurement is on track to deliver an award recommendation by the end of July. The group is in the process of pulling together a balanced board and governance arrangements that give equal weight to incumbents and new entrants. A new chief executive, Ben Jeffs, was appointed this month. Articles of association have been agreed by all licensed undertakers and a number of potential new entrant members.

MOSL's budget (sourced from voluntary funding from members) needs to be pinned down urgently. Until Ofwat published its *Roles and responsibilities* document last month, it was understandably difficult for MOSL to move forward on this issue: put bluntly, it needed clarity and certainty on its duties before it could work out what they will cost.

The latest from Ofwat is that it has appointed PA Consulting as its delivery partner, though at the time of writing this was still subject to contract and HMT approval. The appointment should assist with a smooth transition; PA has long been involved with OWML (PA's John Parsonage even had a stint as programme director) and has wide experience in the sector more broadly, so should bring welcome continuity when Ofwat takes the reins. The regulator is understood to also be recruiting resources to help it undertake the programme management work hitherto performed by OWML and to support the programme's customer protection work.

Crucial to all aspects will be agreeing a budget for all this. Ofwat last month said it was working through the cost implications of the work and would provide further information in due course.

In the meantime, it is good to see the transition issues haven't held up day to day progress. Since the bulk of MAP3 was published on 11 May, more documents have come out from Open Water: on data upload requirements, responses to MAP2, company readiness (see box, above) and an Assurance Framework (see box, left) DEFRA's work, particularly on exit, is also understood to be on track. TWR

ASSURANCE FRAMEWORK

The draft Assurance Framework, published as Technical Appendix 5 to MAP3, defines the high level assurance components and activities to be undertaken to provide confidence to all parties in relation to the implementation of the non-household retail market.

It identifies the following key risks to the programme:

- Uncertainty and continuing changes to the governance structure, decision making framework and roles and responsibilities leading up to April 2017 has the potential to create delays, lose delivery momentum and impact the success of market opening on 1 April 2017.
- The number and range of organisations/ groups involved in the market opening implementation, working independently of and parallel to one another, all with delivery responsibilities, creates interdependencies and poses a risk to the success of the market opening if not fully coordinated and integrated.
- Failure to coordinate with the Scottish arrangements may result in incompatibilities between the English and Scottish markets and affect the seamless customer experience.
- Failure to effectively engage and communicate with all stakeholder groups, including participants, customers and the wider industry groups, has the potential for varying levels of awareness and understanding resulting in a sub-optimal or dysfunctional market.
- Lack of a level playing field, resulting in preferential treatment, discrimination, hidden cross-subsidies and lack of transparency over costs, may deter new entrants and effective competition.
- An insufficient gross retail margin may deter new entrants and effective competition.

The underlying principle adopted is that the party responsible for delivery of the specific market opening programme requirement will also provide assurance over its delivery. This assurance will be provided by each party's board or equivalent via letters of assurance based on reliable and relevant supporting evidence.

The framework offers guidance on assurance methods, which range from self assessment to independent assurance. This suggests the method chosen should be appropriate for the subject matter and consider risk, criticality and impact. Higher risk and impact areas such as settlement calculations/ algorithms and data readiness could for instance benefit from independent assurance.

It also defines an assurance hierarchy, which illustrates which group/ entity is responsible for providing assurance and to whom the assurance should be provided.

The Assurance Framework seeks not just to confirm whether appropriate mechanics of the market are in place but rather to support the delivery of DEFRA's success criteria and UK government policy, namely:

- All non-household customers in a position to negotiate better targeted more efficient and more cost effective services.
- Outcomes are cost-beneficial for the majority of customers.
- The new competitive markets are fair, transparent and efficient.
- The market delivers a seamless customer experience in England and Scotland.
- Reform incentivises innovation by both existing and new market participants.
- Reforms to upstream markets in England drive sustainable and efficient use of water, encouraging innovation and choice in alternative water resources and sewerage services.

The framework covers activity up to go-live and should enable the secretary of state to confirm whether the market can open as planned.

COMPANY READINESS

Technical appendix 6 to MAP3 covers company readiness and is divided into two parts.

PART ONE: This has been delivered by Oxera and is a practical guide for firms' internal preparations. Key points are:

- **Level playing field.** This is likely to be the subject of an Ofwat consultation later this year. Oxera recommends pricing transparency (for instance on intra-company transactions and tariff structures negotiated with retailers); new governance arrangements around non household retail information flows (through separate IT systems, offices, managements etc); and demonstrable compliance (via training, employee codes of practice and so on).

- **Data cleansing and validation.** Data requirements are detailed in the data catalogue published alongside MAP3. The Oxera report recommends companies make as early a start as they can given the extensive time and effort data issues have taken in other markets. It points out that the readiness date for this activity will be when shadow operation starts in 2016, not when the market opens in 2017.

- **Interactions with the DWI and EA:** The roles and responsibilities of wholesalers and retailers will need to be clarified in crucial areas such as water quality monitoring and trade effluent consents overseen by Defra, the DWI and the EA. The statutory wholesale-retail code will only be able to be finalised once this is worked through.

Ofwat is expected to propose a new licence condition in its licensing consultation obliging companies to carry out data and regulatory interaction activities.

PART TWO: This has been delivered by Gemserv and covers what companies need to do to operate under the new market architecture. It includes the objectives that will need to be met, poses questions for companies to consider and suggests the sorts of supporting evidence that will be required to demonstrate readiness. It suggests tests companies should consider running and which areas might benefit from external audit.

GATEWAY REVIEW DEFINITIONS OF DELIVERY CONFIDENCE

GREEN	Successful delivery of the project/programme to time, cost and quality appears highly likely and there are no major outstanding issues that at this stage appear to threaten delivery significantly
AMBER-GREEN	Successful delivery appears probable however constant attention will be needed to ensure risks do not materialise into major issues threatening delivery.
AMBER	Successful delivery appears feasible but significant issues exist requiring management attention. These appear resolvable at this stage and if addressed without delay, should not impact delivery or benefits realisation.
AMBER-RED	Successful delivery of the programme/project is in doubt with major risks or issues apparent in a number of key areas. Prompt action is needed to address these, and whether resolution is feasible.
RED	Successful delivery of the programme/project appears to be unachievable. There are major issues on project/programme definition schedule budget, quality or benefits delivery, which at this stage do not appear to be mangeable or resolvable. The project/programme many need to be re-baselined and/or its overall viability re-assesed

INDUSTRY COMMENT

UNCHARTED WATERS – BUT NOT TERRITORIES

The future water market is uncertain. How can companies effect business change without regretting it later? And what can they learn from other sectors that have faced similar conundrums? By PA Consulting Group.

Prior to full competition, water companies had a straightforward way of setting their strategy and change approach. The business model was mature, the customer base was static and margin improvements could be made by exploiting technologies such as asset management GIS and CRM systems. But the landscape has significantly changed following the Water Act and hard decisions must now be made for the future.

Banks and efficient governance

Splitting a business into separate retail and wholesale activities is undeniably a complex operation. But it is a well-trodden path within the utilities sector and importantly in other industries too and water companies can learn from how those firms went about it.

In the financial sector, firms are currently implementing regulatory change to separate their retail arms from investment banking as part of the response to the 2008 world banking crisis. The regulator, in the form of the Prudential Regulation Authority (PRA), has not mandated separate programmes, governance boards or underlying systems. Instead they are focused on the outcome: will the banks be able to demonstrate they are running independent businesses that are in the consumer and the nation's interest? Whether there are two layers of governance or twenty isn't the concern of the PRA. Nor is there a requirement to run completely stove-piped organisations. As long as separate operations can be demonstrated then a bank passes the test.

In the water industry, where Ofwat has deliberately provided a high level definition of the level playing field, a similar approach could and should be followed. That means avoiding over-elaborate or ineffective governance structures and ensuring agility and ease of decision making.

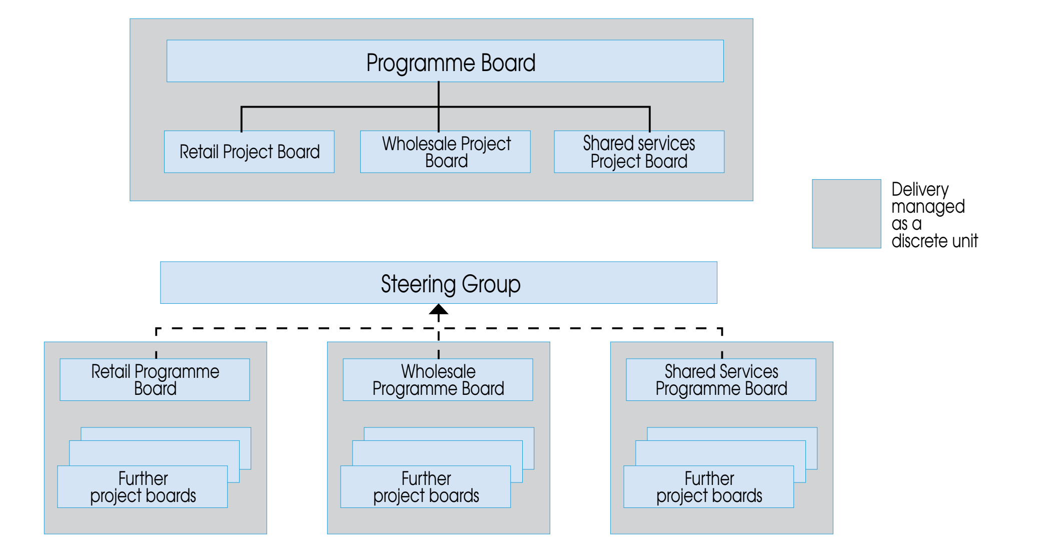
Reports from the National Audit Office on failed programmes explicitly blame governance complexity for contributing to wasted spend. Water incumbents need to resist the temptation to add layer upon layer of complexity and focus on the outcomes rather than the delivery mechanism.

The diagrams provide two models that achieve the same outcome.

The first shows a simple structure where a single governance group has responsibility for the whole change. The delivery is subdivided into discrete projects that deliver components of the change.

The second diagram demonstrates how governance can proliferate if responsibility for delivering the change is separated into a number of individual programmes. Each of these require individual governance as well as a further layer of processes to integrate decisions across each programme. This is clearly much more complex and will introduce significant cost and lag in decision making that would severely jeopardise a 2017 market-opening deadline.

GOVERNANCE OPTIONS: SIMPLICITY V COMPLEXITY



Pay-as-you-go IT

The uncertainty of the future market creates challenges for the IT needed to support it. Decisions need to be made about whether there will be a requirement to support an increase in pure customer numbers and how IT systems will have to scale up in a linear way to keep costs under control. Alternatively, they may need to target particular customer segments with a tailored experience and ensure they have the analytics capabilities to target the right in-area and out-of-area customers.

One of the biggest complaints around traditional software licensing comes from the high degree of uncertainty about lifetime cost and return on investment. This may explain the popularity of the "pay as you go approach" of Software as a Service (SaaS) and cloud-based computing in recent years as it allows organisations to scale up or down and move costs to opex.

In financial services, the example of "challenger" banks which have seen a doubling in market share over the last three years, in parallel with the adoption of cloud-based computing, shows the potential impact. The OFT estimates that IT infrastructure accounts for two thirds of a start-up bank's total costs. SaaS is credited with lowering this barrier to entry and facilitating the expansion of new entrants such as Metrobank. This has seen the number of its UK branches increase ten-fold in the last decade whilst its IT department still comprises only three people.

However water companies, traditionally characterised by a patchwork of legacy IT systems, are yet to fully embrace the opportunity presented by the market proliferation of cloud services specifically designed with utilities in mind. But there are some examples that show the potential of SaaS – Severn Trent Water recently cut its annual IT support costs by £1million by switching to a cloud based billing system.

However, UK water firms should remain pragmatic about the use of these new technologies and service models, since they still have key challenges to address in legacy IT. Investment needs to be made in existing IT systems and a balance must be struck to ensure core compliance in current wholesale systems. Equally, experience has shown that it can be difficult and time consuming to implement cloud based solutions across an established IT environment. All this means that providing effective and regulatory compliant integration of in-situ systems and the cloud is a challenge that requires well thought out investment but the problems it presents are not insurmountable.

Data: comply, compete or both?

By participating in the competitive market, organisations will need to share data with both the market operator and with one another and they need to make sure that the data is in the right form to be shared.

The quality of that data has implications for compliance with the level playing field if inaccurate data prohibits effective market operations.

Organisations face a decision about their approach to data: do they use it to focus on complying or competing – or even both? In order to comply, the priority should be on the quality of data shared with other parties. That means understanding where the risk lies. For example, as part of recent changes to the classification of government documents a large government department focussed their efforts on making changes and ensuring compliance on documents that they share with external parties. This was the biggest risk to their activities, so the lower risk reclassification of internal documents was tackled in a subsequent phase.

In order to compete, the focus needs to be on ensuring the value of the data as, in a competitive world, information and knowledge is the driver of greater market share, securing new customer segments and higher margins. In the new water market a key area to consider is the identification of "gap sites". In Scotland, they identified more than 10,000 gap sites over 18 months and new service providers were created to meet the needs of those customers.

The challenge for incumbents is that new entrants to the market don't have to deal with legacy data and can focus on using their data to compete by understanding more about their customers and growing their market share. A good example of this is Amazon who uses its Amazon Web Services capability to gain insight into customer behaviour. They have also created common standards for interoperability between their internal systems so they will be able to combine them in the future to address new markets or customer needs.

In the water sector vertical integration was a historical key driver, sometimes delivered through technology but often through co-locating teams and joining up business processes. In the new level-playing field world this cannot exist and organisations operating within both retail and wholesale will need to put appropriate interfaces in place. For them, compliance will be a key focus but the attraction of competing and gaining market share will remain highly compelling too, and cannot be ignored.

> **Water incumbents need to resist the temptation to add layer upon layer of complexity**

Competition needn't stifle collaboration

Industry participants should recognise that every company in the industry is facing similar challenges. It is all too easy to use competition as an excuse for each water company finding their own way to solve the same problems. Yet that may not be the most efficient or effective approach.

Sharing information and collaborating across industries is at the core of the business plan of the Open Data Institute, (chaired by Sir Tim Berners-Lee and Professor Nigel Shadbolt). This has government backing and is gaining momentum by demonstrating how, if data is shared openly rather than hoarded internally, both organisations and the economy as a whole benefits. The Institute also acts as a stimulus for innovation, for example, using shared data to improve the energy efficiency of over 20,000 commercial buildings in the UK.

This underlines that there are real benefits to be gained from water companies being proactive and not waiting for everything to be defined at the centre. Ofwat and MOSL won't consider the lead times and dependencies for delivery within the regulated firms. So there is an opportunity to work with fellow industry participants to develop the standards and offer those back to the regulator. This gives the industry more control over what the standards are, and assurance that, when they are available, they will fit the collective systems footprint and provide greater certainty to all.

Certain components of the new water market are prime candidates for collaboration, for example the definition of a common standard for the operational interfaces that will support data exchange between industry participants.

The example of the Energy Performance of Buildings Directive shows what can be done. Representatives from across a set of home building and energy efficiency organisations worked together to develop a standard for data interchange. This was subsequently adopted by central government as the mandated standard for submitting data to the central register of Energy Performance Certificates. This created standards that were more acceptable to the industry, cheaper to implement and industry had greater certainty about the technology and processes that they needed to support. A similar approach in the gas sector saw all participants in the SOMSA programme, which separated out the gas control systems, coming together to establish ways of working to meet challenging timescales.

Whilst the changes in the water sector are unprecedented, there are many lessons that can be taken from other industries on what worked and what didn't. These show that a rapid but pragmatic and informed decision-making approach is critical, underpinned by embracing technology trends, such as software as a service.

So while uncertainty is a reality, water companies have to face up to the fact that it doesn't have to be an obstacle to a successful outcome in the competitive water market of 2017.

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Anglian Water Business will shortly have a quarter share of the Scottish retail market. Managing director Bob Wilson talks about winning the £350m public sector supply deal – and his English market ambitions.

HIGHLAND GAINS

"Euphoric but cautious" is how managing director Bob Wilson described the mood at Anglian Water Business (AWB) when we met early this month. The company anticipates being awarded the contract to supply water and wastewater services to the Scottish public sector shortly, having been named preferred bidder back in February.

The euphoria is easy to explain. The contract is huge, worth around £350m and serving over 200 public sector organisations over 15,000 sites and 27,000 supply points. It will take AWB's market share from a couple of per cent to around a quarter of the entire Scottish market. The three year deal (with a 12 month extension option) was tendered in two lots by the Scottish Government in August 2014: lot 1 to supply local authorities and social landlords; and lot 2 to supply a range of other public sector organisations including health bodies, colleges, central government departments and the Scottish Parliament. To win both lots away from incumbent Business Stream is clearly something for the company to celebrate.

Being cautious is borne of experience in the first half of this year. The contract award hasn't run to plan. Since Scottish Procurement (acting for the government) announced AWB had preferred bidder status, the process has been at a formal standstill – temporarily initially, and then open-ended – while objections and queries were explored. These are understood to have concerned the tender process itself rather than AWB's bid specifically. A short period of ten days was always scheduled in for this, but for the standstill to drag on for four months was unexpected and unusual. Possibly the timing of the general election hasn't helped.

Within the next couple of weeks though, Wilson hopes to put all that behind him and get on with the job. There will be a further ten-day wait period once the contract award is announced – again for other bidders to raise objections or queries (though you would hope these would have been dealt with already) – after which it should be all systems go. Although precise timings can't be nailed down just yet, Wilson is now working to an expected start date of 1 October, which will be six months later than originally planned.

Best bid

The big switch will be conducted from AWB's Edinburgh office and overseen by local business development manager Tony March. Wilson says the company is well prepared for the transfer itself and that around an additional 40 staff will be needed to serve the new customer. There will also need to be a comprehensive communication programme for both public sector customers and other stakeholders.

Wilson explains that, because of the way the tender process works, unsuccessful bidders are privy to far more information on the preferred bid than the preferred supplier is to its competitors' bids. So he does not have precise detail on how much

> **We weren't the cheapest. We have to offer competitive discounts to be in with a chance of winning new business. But the real edge we have over other suppliers is our proactive approach to helping customers reduce their consumption**

better a deal AWB offered than others. But he does know that saving money is crucial for the public sector right now, and that this dominated the buyer's priority list. "Ensuring taxpayers benefit from value for money has been the top priority for the Scottish Government throughout this tender process," he observes. "We have estimated we can make savings of tens of millions of pounds for the Scottish Government over the contract term."

Crucially, though, these savings won't come purely from discounts but also from savings delivered through proactive consumption management. "We weren't the cheapest," Wilson says. He elaborates: "We have to offer competitive discounts to be in with a chance of winning new business. But the real edge we have over other suppliers, and one of the reasons we get so much repeat business [having not lost a customer in the Scottish market since it opened in 2008], is our proactive approach to helping customers reduce their consumption, which can deliver far more savings for the customer overall."

He stresses the "proactive" in that sentence: AWB's offering centres on identifying and delivering real opportunities for the customer to save water or minimise wastewater – for instance, through high consumption alerts by phone – rather than simply providing data. And he emphasises that water savings are routinely accompanied by energy and carbon savings and improved business resilience. So while water is plentiful in most parts of Scotland and conserving it for environmental reasons is far less pressing than, for example, in AWB's water-stressed East Anglian homeland, saving water for the Scottish Government equates to saving money.

In addition to bottom line savings, Wilson explains his bid also offered the extremely varied public sector organisations a customised, tailored service. "We focused on offering quality and added value for individual customer types within the public sector," he says. "We have developed propositions specific to Scotland and to different sizes and types of consumer."

We've rolled everything to do with being ready for the English market – our billing system, our people, our offices – into being ready for the Scottish Procurement tender

If that sounds like a lot of work, it was. "It [the win] was not luck," Wilson emphasises. There was a long term game plan. This started back in 2010 after AWB lost out to Business Stream when the Scottish public sector first went out to tender. "We realised how difficult it would be to win the tender away from the incumbent, how much work it would entail. So we've looked at every element and tried to move ourselves forward. We knew we couldn't sweep the board, and we knew we'd have no idea if we were cheapest on price. So we set out our stall around adding value, and edging forward that way."

To illustrate his point, he refers to out-of-hours response. "This was important to Scottish Procurement. We have experience of out-of-hours response in East Anglia of course, but we made sure there was no arrogance in our approach, so we didn't just assume we could do the same for 15,000 sites in Scotland. We got an out-of-hours service up and running specific to Scotland, to prove we can actually do this."

In fact, well beyond that, AWB has been ever mindful of the fact that the Scottish tender would be up for renewal in 2015 as it has laid its plans for the opening of the English market in 2017. "We've rolled everything to do with being ready for the English market – our billing system, our people, our offices – into being ready for the Scottish Procurement tender," Wilson reports. "We didn't want to mesh Scottish Procurement in to what had gone before [pre-separation]." These readiness preparations include a new customer relationship management system, a new billing system, new telephony with advanced call monitoring and analytics, and an expanded team of account managers and customer service staff.

English ambition

Wilson says AWB intends to be "a very serious contender" in the English market, with few restrictions on its ambitions. "To do that, you've got to have a strong proposition across most segments. Otherwise you end up being niche." He feels confident in this: "Our experience runs across a wide spectrum. We've got the petro-chem industries on the Humber Bank. We have extensive experience in agriculture and food processing as well as a range of commercial and retail customers."

And while the company isn't intending to restrict itself to any particular sector, Wilson doesn't pretend taking the Scottish public sector won't be advantageous when the time comes to talk seriously to the English public sector. The Crown Commercial Service is known to be engaging already with suppliers and the market programme to explore its options. "We'll go into that process as the only retailer to serve the public sector in another company's area, so we'll be well placed to be a part of that process in England."

In terms of its internal preparations, Anglian Water is making good progress on the functional separation of its wholesale and business retail units. Some of the investments mentioned earlier – the new billing, CRM and telephony systems, for instance – have been made in pursuit of this separation, with AWB standing on its own two feet. Most obviously of all, a few weeks ago AWB moved into a new office in Peterborough. Its livery is not even yet over the door, and many of its systems have just made the transition from being shared to stand alone. Wilson comments: "All the decisions have been made, we just have to put the last few pieces of the picture in place as the legislation is firmed up."

Meanwhile, arm's length treatment between Anglian's wholesale and retail businesses has already begun in earnest. Wilson does not envisage any difficulty acting in the interests of retail where he has to. "As a national retailer, it's hard to see how we'd end up in a vastly different situation from the wholesaler. We interact well with Scottish Water and would expect to do the same with Anglian Water as a wholesaler. We'll react the same if they don't fulfil a customer KPI as we would with any other wholesaler. Most of that will be governed by the market framework anyway."

Wilson adds: "We are clear that we wish to run our in and out of area businesses together." The company is keeping close watch on how the retail exit regulations pan out, and will assess in due course whether or not to take the exit-to-compete route.

In building its retail proposition, AWB draws on over a decade of experience of competitive initiatives. Wilson says: "The core of our team have been doing this for a long time for Anglian. We've recruited people in the expectation that competition would come earlier, and we've been there at every step" (see box). Far from being a waste of time, he believes flying the flag for competition for so long will pay off – first and foremost because it has put competitively minded people in place to deliver now things are hotting up.

Beyond that, Wilson says "there has been learning from every competitive initiative," and that AWB has taken care to apply these lessons to improve services for its in-area customers. He cites Asda, for instance, whose East Anglian stores receive the same levels of service from AWB as the 64 Scottish branches that negotiated added value services from the retailer when they switched to it in 2011. Betfred, similarly, enjoys AWB's Active Water Management service across eastern England as well as in Scotland, where 99 of its stores opted in in 2013.

On the market

As far as the development of the market goes, Wilson is reasonably sanguine about two issues that are getting negative attention elsewhere: thin margins (a c6% average gross retail margin, compared to 26% in Scotland) and complex wholesale arrangements. AWB has geared up to compete in a thin margin market, pinning its colours firmly to the mast of consumption reduction and service not volumetric price cuts. He asks only that retail margins are "adequate", commenting that currently they look "tough, but time will tell".

Nor does he envisage major difficulties stemming from variance between the different charging structures, service standards (and potentially credit terms) available from different wholesalers. He views the current outlook as "not ideal, but not insurmountable" but over time believes rationalisation will come. "Differences are inevitable," he says, "but not to the point that there are so many diverse rules that we can't make it work. I think once the market matures there will be regional differences but basic alignment of big ticket issues."

Our interpretation of readiness might need fine tuning, but it won't be like starting from scratch. If others in the industry have been waiting for finite detail, I am concerned they won't have left enough time to get ready

Wilson's main concern is whether all parties will be ready on time for market opening in April 2017 – and the fact that he has no visibility on this. "We've been doing a lot of work for a long time," he comments. "Our interpretation of readiness might need fine tuning, but it won't be like starting from scratch. If others in the industry have been waiting for finite detail, I am concerned they won't have left enough time to get ready. I think an assessment of readiness needs to be defined, and we also need to understand what will be done with that assessment. So for example, if half the companies aren't ready, will the market still open?"

In particular under the readiness banner, Wilson raises the issue of data quality. He sees failure to source and prepare data that will be compliant in the market as the "biggest risk item" and one that would have a direct and detrimental impact on customers – for instance, should they be unable to switch, or should the switch be difficult or bills wrong. Anglian was one of the original members of the Open Water data pilot, which explored using Valuation Office and Ordnance Survey data to create a market data set. Despite this project being shelved, Anglian brought what it had learned in house and continues the work internally.

As for whether the playing field will be level, Wilson says it is too early to say, but flags up the readiness issue again. "If the key players are not LPF ready, the whole market could fall into disrepute." He adds: "We know how much work this has taken us. I appreciate other companies may be starting from different places, so it may not always be as much work as it has been for us, but I think if you sit around waiting for a manual, you may never be ready on time." TWR

IN FOR THE LONG HAUL: ANGLIAN'S TRACK RECORD ON COMPETITION

Anglian Water's interest in, and engagement with, competitive initiatives goes back a fair way and has included over the years:

- **Inset appointments:** Anglian switched Buxted Chicken back in 1997. Its inset activities continue today, with the latest inset granted this year to supply the Northstowe development in Cambridge.
- **h2go:** a business chaired by former gas watchdog Clare Spottiswoode to offer services such as wastewater handling and on-site water treatment to out-of-area industrial customers.
- **Water Grid:** a JV between canal manager British Waterways, Anglian, Bristol Water and Partnerships UK. The aim was to supply sustainable water and wastewater treatment services using canal water to industrial, commercial and property development customers. The JV couldn't undercut incumbent water companies in most cases.
- **AWB in Scotland:** AWB was the only English incumbent active in Scotland when the market first opened in 2008, trading under the Osprey brand. Its first switch, in the opening year, was with betting chain Ladbroke's, followed the year after by pub chain Belhaven. Their customers now include Asda, Starwood Hotels, Betfred, Matalan and TJX (parent company of TK Maxx).
- **AWB brand:** was launched in 2011
- **Open Water:** most recently, Anglian Water has taken an active role in the Open Water programme, participating both as AWB the retailer and Anglian Water the wholesaler. In addition, Peter Simpson, CEO of the Anglian Water Group, is one of three water company chief executives to get Market Operator Services Limited off the ground – to procure central IT systems and establish an enduring market operator, among other roles.

According to Wilson, Anglian's enduring interest in competition is tied up with its water efficiency ethos, manifest today in the Love Every Drop messaging. He explains: "Everything we do is to help the region use less water. We recognise that it is good for both us as a company and for the customer to encourage efficiency, and we recognise that business customers have a great impact on resources and the network. That's why, for instance, we launched our Active Water Management service – to minimise bills for companies by helping them to reduce their consumption.

"As a company we are not scared of doing the right thing. For businesses, we have set out to decouple business growth from rising water consumption."

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