DECEMBER 2016

THE WATER REPORT

POLICY | REGULATION | COMPETITION

Talking on water

Customer engagement at PR19 and SRC21

INSIDE OUTCOMES CONSULTATION AND WATER 2020 | DEE VALLEY BIDS | BLACK & VEATCH'S CINDY WALLIS-LAGE

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THE WATER REPORT COMPETITION WATCH

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EDITOR'S COMMENT

Engaging times

This month we delve into the challenging world of customer engagement in both Scotland (see p8-10) and England and Wales (see p12-16). Regulators in both jurisdictions are planning to refine the – different – models they used at their last price controls at the next price rounds in 2019 and 2021.

We focus in particular on the research methods companies will use to establish what customers want and value. This follows a challenge from Ofwat to engage more richly ahead of business planning for 2020-25; in particular to cross check (or 'triangulate' in research-speak) the results of stated preference willingness to pay surveys.

The aim is laudable and the industry has embraced it. Last month Thames Water, Water UK and CC Water hosted a well attended workshop to discuss options. However there is a definite 'can of worms' side to the development. There is a dizzying array of research options out there, and sorting the wheat from the chaff situation to situation won't be easy. There could be conflicting messages from different sources of data on the same issue, and research could breed research.

And at an industry level, there will almost certainly be less comparability as both research methods and triangulation techniques diversify. How this sits in the context of initiatives designed to enhance comparability – from the updated Discover Water website to the ten common performance commitments Ofwat has suggested for PR19 – remains to be seen.

Another danger is that having given companies control of engagement, Ofwat could look unfavourably on particular methodologies (or the use of particular methodologies in particular contexts) down the line. Without being prescriptive on company choices, some kind of steer on what weightings might be attached to different data sources could help cut through the treacle.

Engage with us

A plea while your minds are on customer engagement. For us at The Water Report, you, our readers, are our customers. And we want to make sure that, two years on this month from our launch, we are serving your needs satisfactorily and delivering information that is useful to you. So among your Christmas and New Year emails, please look out for a short survey from us (which I will triangulate with qualitative research in the form of ad hoc conversations). We'd be very grateful for any comments and feedback.

Happy Christmas to you all.

Karma Loveday, editor,
The Water Report

Feedback, comments and suggestions very welcome.

Contact me on karma@thewaterreport.co.uk or 07880 550945.

THE OUTLOOK FOR OUTCOMES

Following publication of its Outcomes consultation, David Black talks through prospects for more powerful ODIs, more stretching PCs and building-in resilience – and gives a brief update on wider Water 2020 work.

Ofwat is preparing to beef up the impact of Outcome Delivery Incentives (ODIs) at PR19. That was one of a raft of proposals contained in a consultation published late last month on the outcomes framework for the next price review.

The paper shared the regulator's high level emerging thinking for discussion with stakeholders, rather than pinning down detailed policy proposals. But the message on ODIs was loud and clear: not only will they be part and parcel of the picture for 2020-25, but they could have far more impact on companies than those in play today.

Ofwat puts forward the following suggestions for making ODIs more powerful – note the question isn't whether this should happen, but how:

- Enhancing the reputational impact of ODIs
- Modifying licences to allow in-period ODIs for all companies (see box, p6).
- Linking end of period ODIs to revenue rather than RCV to speed up the impact they have.
- Removing the current aggregate cap and collar which limits rewards/penalties to +/- 2% of return on regulatory equity.
- Encouraging higher overall ranges of rewards/penalties than seen at PR14.
- Adopting industry-standard ODIs for common performance commitments (PCs) with powerful incentives.
- Scrutinising the detailed design of ODIs, such as the use of dead-bands.
- Encouraging companies to increase the proportion of ODIs that carry financial rewards.
- Considering an approach based on a variable cost of equity, that is partly based on how stretching a company's PCs are.
- Looking at whether "gated" ODIs could be used – where rewards are contingent on a company incurring no penalties.

Ofwat's senior director of Water 2020 David Black advised these are not necessarily either/or choices: "There is the potential to do all of them," he said, adding, "they are complementary". If all, or many, of these options were deployed, the punch ODIs pack could be significantly beefed up.

David Black

The Consumer Council for Water has long voiced concerns about the policy, arguing incentives – particularly rewards but also penalties – are unpopular with customers. This position was aired most recently last month when Ofwat issued draft determinations for Severn Trent, Anglian and South West Water on the back of their 2015/16 performance; these companies being the only ones who opted at PR14 to take in-period adjustments. Bernard Crump, central and eastern regional chair, said: "We have never been comfortable with the concept of ODIs. In our research, customers were opposed to rewards for what they saw as companies doing the day job, and were lukewarm about penalties. While we recognise that Anglian and Severn Trent improved their performance last year, they did so against targets that were – in some instances – less challenging than they could have been. The result is bill increases for customers."

Black explains his commitment to the mechanism: "We think it is really important for the sector for financial and customer interests to be well aligned," he said, also referring to criticism previously levelled at the regulator for focusing on financial outperformance alone. Ofwat has oft stated its wider belief that ODIs drive good behaviours and allow higher performance to be targeted as companies beat commitments and frontier companies edge ever forward. Black added that the debate can get "side-tracked" if you look only at the superficial trade off between bills and penalties and rewards. And that in fact, average returns need to be higher if the prospect of outperformance gains is removed (see box – Rewards, penalties and bills).

Setting aside any objection in principle to the ODI policy, it stands to reason that the policy could be more contentious if more is at stake for water companies. In an article in our last edition, Southern Water's chief executive Matthew Wright questioned how rewards and penalties will deal with situations where companies are not pulling all the strings. This related to Southern missing its target in 2015/16 to maintain the number of beaches at excellent standards where external factors influenced performance – for instance, the weather, misconceptions, even dogs fouling the beach. "This is our first experience of an ODI where we are not in complete control," Wright explained. "As you move towards an outcomes based approach, by definition you give up a bit of control…The question is, how should the penalty/incentive mechanism work against that backdrop?"

This is one of many issues to be picked up for further discussion in consultation responses and beyond. For now, Black accepts that more powerful incentives could lead to "greater differences" in company performance, depending on how well each player gets to grips with its PCs.

REWARDS, PENALTIES AND BILLS

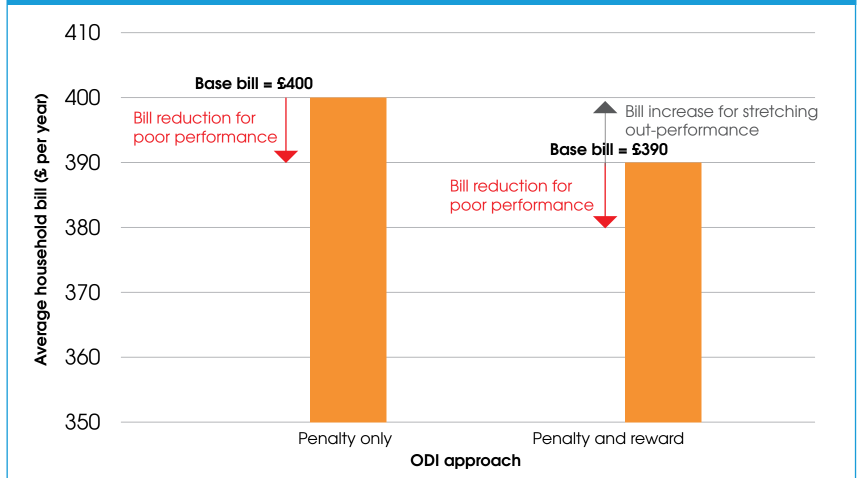
In its Outcomes consultation, Ofwat sets out the case for an ODI regime based on rewards as well as penalties. "If investors were asked to invest in companies with a regulatory system that only allowed for penalties, or downside risk, customers would pay for this through a higher cost of capital," it said.

In the example shown in the chart, the average annual base bill for household customers in a penalty only system is £400. Customers could benefit from up to a £10 reduction through ODI penalties for very poor performance, although in practice companies might avoid penalties altogether or only incur penalties which lead to a small reduction in bills.

Because investors would accept a lower base cost of capital where there is scope to earn higher returns through financial rewards for delivering high quality service, the average annual base bill for household customers in a regime based on rewards and penalties is £390.

Ofwat argued customers would still benefit from a bill reduction if the company performed poorly, whereas if it outperformed it could earn a reward and bills would be higher than the £390 base bill level, but would not be higher than the £400 base bill under the penalty-only system. In addition, customers would be receiving a better quality service for a given bill level; rewards would only be available for service improvements that customers value, as tested through customer engagement.

HOW A PENALTY-ONLY APPROACH CAN LEAD TO HIGHER BILLS



A NEW CUSTOMER EXPERIENCE MEASURE

One of the common PCs Ofwat has proposed is a new measure to replace the Service Incentive Mechanism. The aim is to build on the success of SIM in light of advances in digital communications, customer expectations, service delivery channels, and customer service measurement. According to the consultation: "We want to consider how we understand, benchmark and measure customer service outcomes. This will allow us to ensure that our approach remains relevant, reflects customer behaviour and expectations, continues to incentivise better performance, and really stretches companies in the quality of the customer services they provide – for PR19 and beyond."

Specifically it is consulting on the following aspects:

- focus and outcomes
- service in different parts of the value chain – wholesale and retail
- comparisons with other industries
- seeking views from customers beyond those who have contacted companies or complained
- using more channels to identify customer views
- the impact of complaints data on customer service incentives
- incorporating vulnerability
- including those beyond end users - e.g. developers.

Stretch

It follows that more powerful ODIs might demand PCs to be more stretching, as well as clearly defined and a close reflection of what customers want. Put bluntly, if companies are going to earn greater rewards, they will have to do more to get them; perhaps it is also only fair to say if they are to be hit with bigger penalties, they will need to fail more spectacularly. The Outcomes consultation considers drawing on a wider set of information on customer preferences to set ODI rewards and penalties and looks in detail at the theme of PC stretch.

Some of Ofwat's proposals are likely to go down well across the board – for instance, the plan to improve the information available to customers and CCGs to give them more evidence with which to challenge during PR19. This includes the welcome commitment that Ofwat will provide information on the cost of capital, ranges for ODI rewards and penalties and its wholesale cost assessment approach in advance of companies submitting their business plans. Other sources of comparative information – for instance from CC Water and the upgraded Discover Water website – will be useful too.

Others proposals are likely to provoke more debate. A key area is the balance between common and bespoke PCs. Ofwat has earmarked ten PCs that it considers so important to all customers that "it is appropriate for them to be compulsory for all companies in England and Wales to include in their outcomes packages in their business plans". As shown in the diagram on p6.

Common PCs will facilitate comparing and contrasting companies and hence potentially increase stretch. But the very existence of common PCs provokes a range of related questions, including: should there be standardised ODIs associated with the common PCs and should these be in-period? Should there be common commitment levels for the common PCs? Ofwat suggests this would be appropriate for at least six of them: water quality compliance, customer water supply interruptions, customer property sewer flooding (internal), wastewater pollution incidents, water mains bursts and sewer collapses. This leads to the question of how common commitment levels should be set. Hence the regulator is also consulting on how it could carry out the comparative assessments needed to set these commitment levels. It welcomes views in particular on seven key questions:

- What type of assessment it should carry out (upper quartile, frontier etc.)?
- What performance information should it base the assessment on (historical, forecast or dynamic)?
- Should it set commitment levels for annual or multi-year averages?
- Should it apply the assessments to individual measures or a basket of measures?
- Should it set common commitment levels for the PCs only or also set common penalties and rewards?
- Should there be a time period before the common commitment applies (a glide-path)?
- Should there be any adjustments for company-specific factors?

Ofwat has also turned its attention to bespoke PCs. It is seeking views on whether there are particular areas that all companies should cover with their bespoke commitments – for example, those related to vulnerable customers – and asking how it can promote stretch in its guidance on setting bespoke PCs.

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PROPOSED COMMON PERFORMANCE COMMITMENTS FOR PR19

1. New customer experience measure	2. Water quality compliance	3. Customer water supply interruptions	4. Water distribution input (or leakage and per capita consumption)	5. Abstraction incentive mechanism
6. Customer property sewer flooding (internal)	7. Wastewater pollution incidents	8. Asset health water - pipebursts	9. Asset health wastewater - sewer collapses	10. Possible new measure or measures of resilience

Customer satisfaction | Current performance | Resilience/future performance

In the round, this all sounds like a move towards rationalisation. Black said it is less about rationalisation, and more about general improvement and embedding learnings from PR14.

Resilience

The consultation also calls for views on how to better reflect resilience in outcomes. Among its proposals are:

- Resilience planning principles for PR19 – it offers draft principles for discussion.
- Inclusion of the quality of a company's customer engagement on resilience and long term issues in the the Risk Based Review.
- Longer term projections (ten years minimum) to support five year PCs.
- Common metrics on resilience so customers can understand the level of resilience they receive compared with customers in other areas. Ofwat is consulting on two options but prefers the idea of reviewing and adjusting the definition of the common PCs so they better reflect resilience and encouraging the sector to develop a common resilience metric(s). The consultation said: "At this stage we are not proposing particular resilience metrics, but some examples suggested by our stakeholders are: percentage of water treatment works at risk from flooding that have protection in place; percentage of customers with more than one source of supply; and percentage of households served on a tariff or financial incentive scheme that rewards water saving." Ofwat added that it would set out its expectations on how companies should consider, consult on and assess resilience for PR19 ahead of its consultation on the price review methodology.
- A suite of asset health related proposals. These include: asset health expectations, which would include better information for customers and CCGs; reporting on approach to asset health, possibly on a standardised basis; and ODIs for asset health PCs.

Black commented that "the sector is not very good at communicating the resilience of services" and that better information, communication and metrics would inform operations as well as investment. Given Cathryn Ross' recent comments on investment in resilience not being an excuse for rising (or even flat) bills, do companies stand a chance of securing funding for resilient outcomes? Black said Ofwat has "no pre-existing view on the level of bills" and would consider any proposal "backed by sound evidence from customer engagement". He added though that "overall affordability must be considered as a factor" too.

Stakeholders have until 31 January to respond. Ofwat will feed responses in to the formation of its PR19 methodology consultation which will be published in July 2017. This will be followed in December 2017 by publication of the PR19 methodology statement. TWR

SECTION 13 FOR PR19

Catering for in-period adjustments to revenues for ODI rewards and penalties at all companies (the 17 appointed companies in England and Wales) is one of four key changes Ofwat is looking to make to water company licences ahead of PR19. In a separate November consultation under section 13 of the Water Industry Act 1991, the regulator also proposed modifications to cater for: indexing revenues to CPI/H instead of RPI (if committed to deciding which by January 2018); setting four wholesale price controls (water and wastewater network plus controls, together with controls for sludge and water resources); and establishing market information databases for sludge and water resource activities.

No doubt keen to avoid another clash over licences, the modifications have been co-developed with the industry; since July, Ofwat has worked with the 14 companies who indicated support in principle to develop the detail of the licence modifications needed to implement May's Water 2020 policy. According to Black, it has been challenging translating policy principles into licence conditions but he is pleased with the level of industry engagement. "There has been maturity on both sides," he commented, adding that the three companies who didn't opt-in "had good reasons". He accepts there may be some differences of opinion on the precise wording of the licence modifications Ofwat has settled on, but expects all companies to accept the amendments.

PROGRESS OF OTHER WATER 2020 WORK

Outside of outcomes and licence changes, Black reported solid progress on other aspects of Water 2020 work. He said 2015-16 had been a year of "blockbuster policy" whereas 2016-17 is about making policy reality. He said he was particularly excited to see companies getting involved and working through the detail of how what can be "quite abstract" principles will affect real operations.

A number of multi-stakeholder working groups are crunching through this: one each on bioresources and water resources, dealing with practicalities such as where the boundary should lie between the network plus and the activity-specific price controls; and another group on cost assessment, which is scrutinising PR19 modelling and the data requirements for those cost models. Work continues on cost of debt and equity, with more detail on the latter to come in the July methodology consultation.

Is Black concerned about the growing complexity of water regulation and its affect on investors? He remarked there is "a balance to be struck" here: Ofwat is challenging itself to minimise unnecessary new complexity and to strip out complications from earlier price controls that are no longer needed; but at the same time it is important to acknowledge the potential benefit of the new policy developments. "Some of this will unlock big efficiencies," he said.

CUSTOMER FORUM TO CUSTOMER JURY

WICS scopes out refinements to the SRC15 model of direct company/customer negotiations for SRC21 – in the form of a "Customer Jury"

A "Customer Jury" would represent Scottish customers at the next price control, under plans put forward for discussion by the Water Industry Commission for Scotland. The Jury – a working title for the group envisaged by the regulator – would be a fine-tuned version of the Customer Forum that was used when prices were set for 2015-21.

WICS suggests this model of customer engagement in the latest batch of papers it presents for the scrutiny of its "Advisory Panel" – a group of experts who provide comment, challenge and insight on the regulator's proposals for how the regulatory framework could be enhanced ahead of the next price review (see box – WICS Advisory Panel). None of the ideas WICS has put forward to the panel over the past year are set in stone. But in the case of customer engagement, building on the Customer Forum seems a logical step. It, and the unswervingly customer-centric process of the last Strategic Review of Charges (SRC) more broadly, are widely regarded as a major success.

Customer Forum and SRC15

The last price review was characterised by direct and successful company/customer negotiation. WICS comments in its recent paper: "We believe that the Customer Forum approach adopted by WICS for the 2015-21 review was the first in the UK which truly put customers at the heart of the regulatory process." Scottish Water worked directly with customers, represented by the Customer Forum (led by former Scottish Executive minister and MSP Peter Peacock), to agree a business plan for 2015-21. The two parties found agreement on a price, service and investment package. In March 2014, the Commission honoured its commitment not to interfere with such an agreement (providing it fitted in with the regulator's upfront specifications – see below), and translated this agreement into a draft determination. On 11 November, it signed off a final determination. This was unchanged from the draft, bar the addition of a single new incentive to ramp up Scottish Water's action on leakage.

The process was supported by the regulator's ongoing efforts to keep things simple, clear and predictable so customers could take part effectively.

WICS was also absolutely clear about its expectations of the SRC upfront. It published ranges for each of the material inputs to the price setting process, including: a proposed approach to inflation; a cost of allowed debt; growth in household and non-household customers; prospects for operating costs and scope for efficiency; prospects for capital expenditure and the scope for efficiency; scope for improved levels of service; improvements in the monitoring of performance; and prospects for prices. It also commented on developments openly throughout the process.

This was the reverse of the traditional price review approach, where company and regulator act independently of each other and share little information until the back end of the process. Indeed the review contrasted starkly with Ofwat's for PR14: this was staunchly non-prescriptive about its expectations at the outset in the name of giving customers a free voice and allowing companies to own their plans.

WICS believes its process offered many advantages over Ofwat's Customer Challenge Group model and other alternatives. It lists: greater transparency; a more targeted outcome as the company was able to flag up particular areas for detailed discussion where it felt it had been harshly treated; strong customer legitimacy; increased planning time for Scottish Water (effectively it was able to plan from the issue of the draft determination); and encouraging Scottish Water to be accountable to customers rather than the regulator. Particularly relevant on this last point is the confidence WICS provided that an in-range company/customer agreement would stand. WICS comments: "If Scottish Water were to think otherwise, its focus would continue to be primarily directed at the regulator rather than its customers. There is clear evidence from the Ofwat Customer Challenge Group process that the regulated companies were most interested in the views of Ofwat."

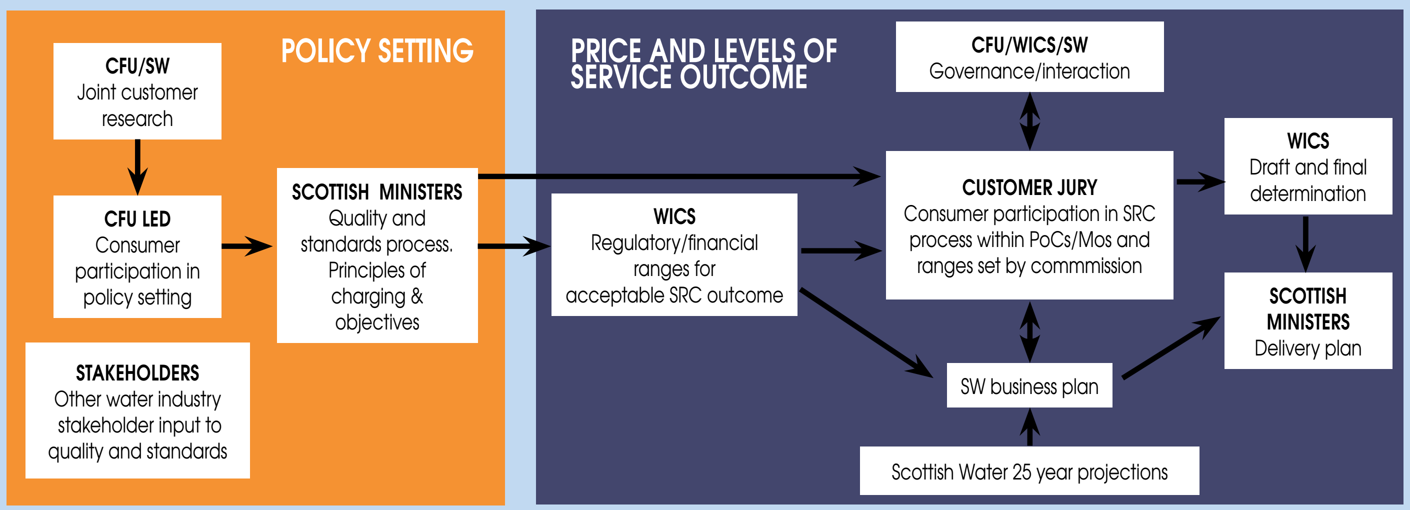
Improvements

But now the Commission is looking to make its customer engagement approach even better, by fine-tuning the Forum into a "jury". Its use of the word "jury" stems from an courtroom analogy: "The Customer Forum approach can be seen to be…akin to the concept of a 'Customer Jury', where Scottish Water is required to make a case to its customers that its proposals are reasonable. In this analogy, the Commission becomes the 'judge', setting the remit and framework within which the discussions are held and ultimately informing the outcome."

To improve the quality of the jury, the judge proposes the following refinements to the Customer Forum for SRC21:

- The timing, profile and importance of the Commission's decisions. WICS points out: "A fundamental principle of the Strategic Review process is that it is the Commission who ultimately takes decisions. Under the revised approach to price-setting, it is important to understand that the Commission takes an important decision each time it sets a new set of ranges or, indeed, comments (either positively or negatively) on an input to the process from Scottish Water. It will be important to ensure that the SRC process includes sufficient opportunities for discussions between the Commission and Scottish Water to inform the setting of these ranges."
- Role and remit of a Customer Jury. These would remain similar to that of the Customer Forum: "to act on behalf of customers (as a whole) to seek agreement with Scottish Water within acceptable ranges set by the Commission, and taking government policy as a given". This is not to be confused with the wider customer policy setting role to be played by the water customer representative body the Consumer Futures Unit within Citizens Advice Scotland (CFU/CAS – see diagram).

OVERVIEW OF CUSTOMER ENGAGEMENT PROCESS



WICS ADVISORY PANEL PROCESS

WICS has convened an Advisory Panel of independent experts to provide comment on its thinking on how the regulatory framework should be enhanced. Representatives of Scottish Water and the Scottish Government also participate in the process.

To inform the discussion and provoke debate, WICS chief executive Alan Sutherland has set out his thoughts on possible developments of the regulatory mechanism in a series of discussion papers which have been published over the past year. These have covered subjects including deepening customer involvement in the industry, achieving better value for money, financing, governance and long term spending issues. The main article covers the set of papers published this autumn, which deal with customer engagement, capital maintenance provision and the monitoring regime. These build on ideas in papers published to date.

The Advisory Panel is asked to discuss, challenge and comment on these discussion papers, after which WICS will finalise its proposals and prepare a draft methodology statement for the next price review. This methodology is expected early next year.

MAINTENANCE AND RESILIENCE

WICS deals with capital maintenance in a separate paper in this autumn's batch. This builds on a previous Panel discussion of the condition and lives of Scotland's water assets, along with maintenance allowances and Scottish Water's associated expenditure. In its latest thoughts, WICS puts forward a number of mechanisms for discussion to ensure the appropriate level of resources for maintenance activities will be available at SRC21. This follows analysis which concludes there is currently broadly sufficient spending on maintaining assets but that, at some point in the future, there will likely be a substantial bill to replace old and failing assets in asset categories where there appear to be shortfalls in the current levels of replacement. The table compares the expected life of each asset class with the life implied from the current capital maintenance activity. It shows the maintenance of sewers and wastewater treatment plants are "a bit of a poor relation".

The Commission notes in addition that Scottish Water needs to improve the information that it has on asset performance and condition, particularly to be able to demonstrate to customers and other stakeholders that it is managing its assets in the most effective manner possible. Company and regulator are undertaking a programme of work to this end.

For the next price control, WICS has suggested allowing an amount in price limits consistent with the expected average life of Scottish Water's assets but with a proportion of this sum ring fenced for use only after a clear need has been defined and demonstrated appropriately. This will be tucked away in a "Trust Fund". The company would therefore continue to face a hard budget constraint for ongoing maintenance requirements (driving efficiency and innovation) while also accruing resources for addressing expenditure 'spikes' associated with clearly identified replacement needs. WICS says the model would provide for three distinct categories of capital maintenance investment:

- The regular 'within period' capital maintenance allowance which reflects the activity that Scottish Water can clearly demonstrate is required to maintain current service levels.
- A provision for maintenance within the review period that is insufficiently understood, or arises unexpectedly to reflect imperfect asset knowledge.
- Funding for the replacement of assets that extends beyond the current regulatory period. These are the funds that would accumulate in a Trust and be akin to the arrangements in place for the nuclear decommissioning fund, or defined benefit pension schemes.

EXPECTED AND IMPLIED LIFE OF EACH ASSET CLASS

Asset class	Expected life of asset class (years)	Implied life - 60% Gross MEAV, 10 Year Average spend (years)	Variance
Water Infrastructure	155	104	51
Water Non- Infrastructure	42	69	-27
Wastewater Infrastructure	200	507	-307
Wastewater Non- Infrastructure	39	53	-14
Support Services	33	2	31

Like all the ideas in the Advisory Panel papers, the trust fund notion is up for discussion but the Commission said if felt this approach was preferable to the others it considered: the exising "pay as you go" model under which customers' bills increase as and when problems arise; and a balance sheet build up model, under which cash is allowed to accrue on the balance sheet in preparation for the future liability. The problems with the latter are that funds risk being raided to pay for short term objectives, and may distort owner/manager behaviour.

▍Membership. WICS proposes a slightly enlarged group – the nine-strong Forum becoming a ten-strong Jury. In addition to the chair, it proposes three members be appointed by CFU/CAS; three licensed provider members; and three publicly advertised posts. Members would not represent their organisations but act in the interests of customers as a whole.

▍Meetings with the Commission. These would be more frequent that at SRC15.

▍Community outreach. The Customer Forum did not actively seek out the views of local communities or specific groups. WICS acknowledges this was a weakness and notes: "The Scottish Government has made it clear that it is seeking greater levels of community involvement in public sector decision making processes: where 'community' relates both to geographic groupings and also to other customer grouping such as the young, elderly, disabled and disadvantaged." The Jury would therefore take on an outreach role: "The expectation would be that the Customer Jury would work with Scottish Water to establish a joint programme of community engagement."

▍Customer research. Last time around, the quantitive research undertaken was not optimal. The paper acknowledges there were too many, too complex questions and that "the topics covered were too esoteric for the results to be relied upon". It continues: "Looking forward, the proposal is to work jointly with CAS/CFS and Scottish Water to co-ordinate the approach to consumer research across both the policy setting and SRC elements of the process, and to ensure early involvement of the Customer Jury in these discussions. Our view is that the research, which informs the Customer Jury should primarily involve focus groups and interaction with communities to gather evidence of customers' views." The Jury will also have the option of undertaking its own research.

▍Resourcing. WICS has proposed upping the Customer Forum's annual budget of £130,000 a year to £200,000 to pay for the increased membership, more frequent meetings and wider engagement.

▍Monitoring function? Possibly the Customer Jury could take part in ensuring that the agreed business plan is delivered.

Water companies in England and Wales are now starting to grapple in earnest with how best to engage with customers at PR19, following Ofwat's May Water 2020 document which set out its views on refining the PR14 approach (see feature, p12-16). WICS will finalise its customer engagement proposals and build them in to its forthcoming SRC21 methodology. TWR

PERFORMANCE MONITORING

The final Panel paper of the latest set considers how performance monitoring might be improved. The Commission proposes extending the "tramlines" approach it deployed at the last price review to monitor Scottish Water's financial performance to other areas – to the delivery of investment and potentially to the delivery of levels of service.

The SRC15 financial tramlines are essentially a company and regulator agreed framework for monitoring Scottish Water's financial strength over time by tracking its performance against measures commonly used by credit rating agencies, including cash interest cover and gearing. There are five tramlines: the company starts out on the middle line and has the flexibility to perform between the upper and lower limits. If the upper or lower limits are breached, action will be triggered: automatic sharing of outperformance with customers on the top-side; potentially, capital programme cuts or higher charges on the bottom-side. There are two intermediary lines either side of the middle line and these perform an early warning function: should the higher "discussion line" be tripped, Scottish Water would be expected to discuss discretionary outperformance sharing with customers – for instance, charge reductions or additional customer service improvements. Should the lower "warning line" be breached, the company would be expected to explain its position and measures such as interim determinations would be considered.

Going forward, the principle could be applied to the following:

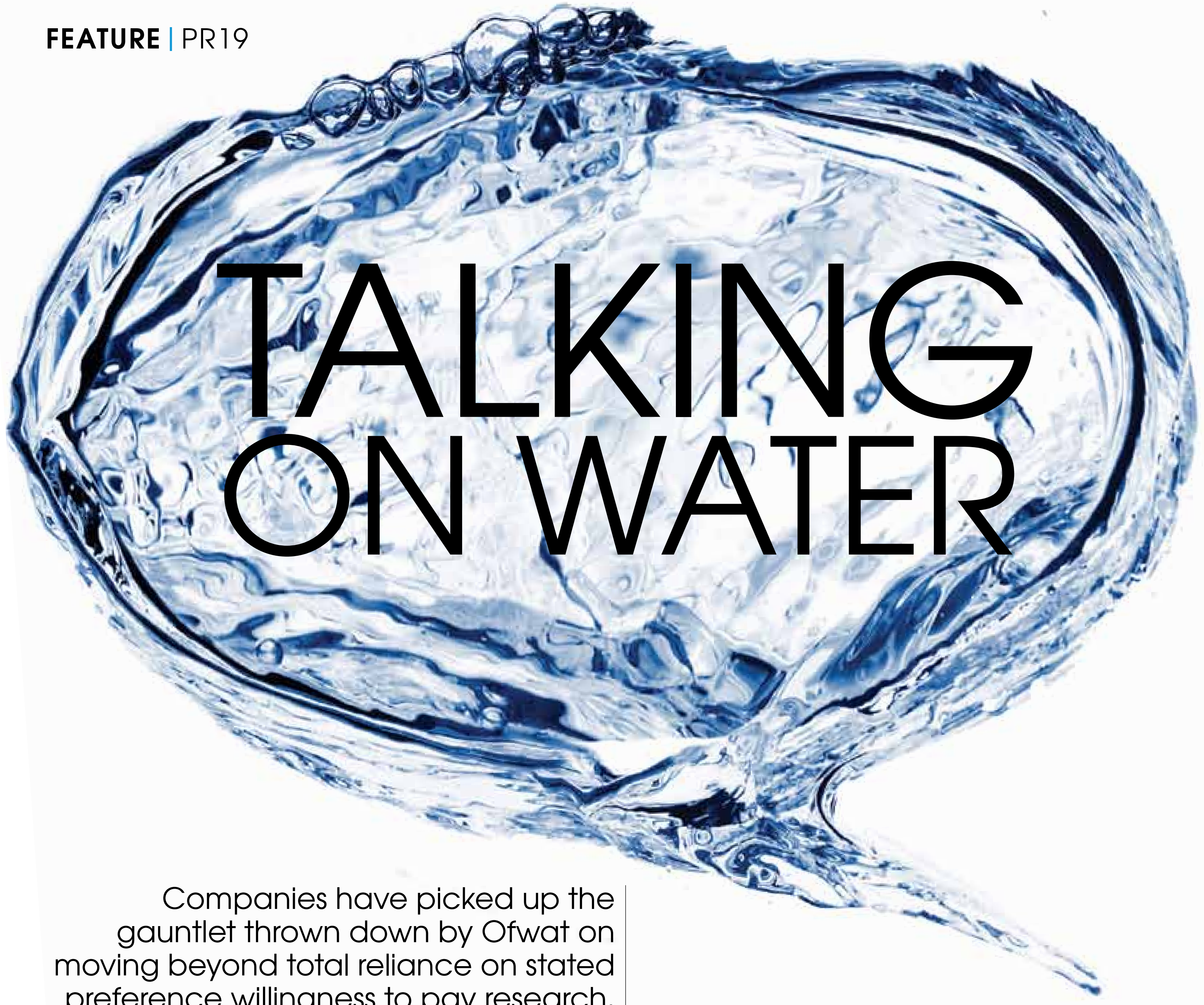
▍**Investment delivery:** This is currently monitored using an approach based on an Overall Measure of Delivery (OMD). This is an index-based monitor of progress across all aspects of the capital programme from the definition of need to the delivery of the required improvement. WICS proposes revising the OMD by developing capital delivery tramlines. These would feature a minimum level of performance bottom line; a top level that qualified as outperformance (which could be aligned to management incentives); a middle line consistent with the expected delivery profile; and a band either side of this middle line. The Commission proposes: "Acceptable performance would be that the capital expenditure programme is no more than three months behind schedule based on the 'middle line' profile (any delay of greater than three months would attract negative comment in WICS's performance report). In the event that progress was more than three months ahead of schedule, the WICS performance report would comment favourably."

▍**Levels of service:** These are currently monitored under an Overall Performance Assessment approach, which WICS considers to have been successful in driving improvements. Three new measures were added at SRC15: a customer experience measure, wholesale KPIs and a high esteem test. The new measures are to be left to bed in, but WICS is looking at enhancing the OPA by continuing to apply pressure to the minimum level of performance Scottish Water commits to and perhaps linking this to bonuses. It ponders: "Is there…some way in which the 'tramlines approach' could be applied to the OPA – maintaining the focus on upper quartile performance? Indeed could a range and tramlines be set around the other new measures that the Customer Forum agreed with Scottish Water and for which the information on performance is still in the trial stage?"

In addition, the Commission asked its Panel to comment on the application of tailored incentives in the style of Ofwat's Outcome Delivery Incentives (see report, p4-6). But its opinion is that "It is not clear that such measures would work in a public sector model where extra return and higher future prices would likely be very difficult to explain".

▍**Financial performance:** WICS has flagged up that it would benefit from more detailed quarterly information from Scottish Water for the next price period; at present the quarterly dashboard reports it receives contain limited information in comparison with interim and year-end reports. The regulator wants the company to share its position within the tramlines at the end of each quarter and a rolling forecast for the next year; and to explain any material changes from its forecast and why it has decided not to release cash to other purposes if it has breached the 'discussion' line.

This follows lessons since SRC15. WICS said: "The tramlines are, potentially an important tool to monitor the financial performance of Scottish Water. However, they rely on transparency and on Scottish Water feeling the benefit of releasing potentially surplus cash to customers or additional service improvements. It is not clear that this is happening as well as was intended. For example, we were surprised by the extent of the cash balance that Scottish Water had been able to build up over the past year, given that it had not had access to Government borrowing. The cash balance was well in excess of what they had forecast."



TALKING ON WATER

Companies have picked up the gauntlet thrown down by Ofwat on moving beyond total reliance on stated preference willingness to pay research. But it's an uphill challenge.

Donald Trump was right about one thing: you couldn't trust the polls. Polling in the run up to the US election, our EU exit referendum and our last general election proved woefully inaccurate; it seems what people say they value and will do, and what they actually value and do, are not necessarily the same thing. Problems then for our water companies who have been charged by Ofwat with more effectively researching what customers want from their water and sewerage services at PR19 than they did at PR14.

There is pretty much universal agreement that the objective is sound. Good customer engagement and accurate insight on customer preferences will lead to better outcomes and increased legitimacy. Regulated industries of all sorts grapple with how best to deliver this, as the report in the box on p14-15 from a conference held last month by the Essential Services Access Network details. We also carry on p8-10 an update on the Scottish regulator's plan for a Customer Jury at the next Strategic Review of Charges for Scottish Water.

For its part, Ofwat confirmed in May when it published its Water 2020 decisions that it would progress the approach it employed at PR14: closer and ongoing customer engagement, continued and improved use of customer challenge groups (CCGs) and a focus on outcomes (see report p4-6).

Richer engagement

There was also a clear expectation of improvement in the quality of companies' customer engagement, which, says Ofwat, will be reflected in the standards it applies to business plan quality in the risk-based review at PR19. Among other comments, the regulator said it would like to see companies:

- "Develop a richer evidence base and reduce the reliance on stated preference WTP survey-based approaches. Where these techniques are used, companies should consider how they could be improved. We made it clear we would like to see companies generally making better use of customer intelligence and exploring the alternative and complementary tools available, for example, by using revealed preference WTP techniques and data gathered from experiments.
- Improve their understanding of the potentially distinct needs and requirements of different customers, including customers in circumstances that make them vulnerable and future customers.
- Continuously inform and educate, as well as seek feedback from customers, including on longer-term issues such as resilience.
- Think carefully about how they can involve customers in service delivery, for example, by co-designing and co-delivering solutions. This could involve more community based approaches to decision making and service delivery where this is efficient and appropriate."

Since the Water 2020 position was published, "triangulation" has become the buzzword. This is a technique that facilitates validation of data through cross verification from two or more sources.

Speaking at the Water 2016 conference last month, Consumer Council for Water chief executive Tony Smith summarised this as a call for "richer engagement". In the round he praised what had been achieved at PR14, noting the very high levels of acceptability of companies' packages and customer focused outcomes that were "the best since privatisation". He called the settlement "really good, but not perfect" and highlighted a number of areas that in his view need attention. In terms of establishing customer valuations (in layman's terms, what customers want), he raised the need to improve and build on the stated preference willingness-to-pay research relied on at the last price review. He added that getting an accurate view of customer preferences will be even more important given Ofwat's support for wider use of Outcome Delivery Incentives for 2020-25 – a mechanism not favoured by CC Water. "If customers are to be charged more, they should have a clear say."

Working together

So the key questions facing companies now are how should they go about establishing customer preferences and how should they go about verifying their findings in a way that will past muster at PR19? In time, each company will of course have to make its own choices, but at the moment the challenge is one the whole sector shares. Last month, Thames Water, working with Water UK and CC Water, offered a helping hand to its fellow companies by organising a workshop which brought together individuals from water companies that are involved in planning customer engagement approaches for PR19, CCG chairs, other key stakeholders and experts in customer research and engagement. The aim was to discuss and explore different approaches to elicit customers' views, how to engage with different types of customers and how to triangulate findings from different approaches.

Introducing the day, Water UK's head of policy Rob Wesley commented the event was "in the spirit of the Marketplace for Ideas" and it certainly felt very much like that. There was a real appetite from the many who attended – all companies were represented – to learn more and do better. And, crucially, there were many experts on customer research and engagement from outside the industry who brought details of particular techniques, as well as observations on best practice.

Ofwat's lead on outcomes and customer engagement Jon Ashley presented too, largely to reiterate the May policy but he did shed a little further light on regulatory thinking. Ofwat's role, he said, was to "enable, inform and incentivise" but it was clearly for companies to take responsibility for engaging with customers. He noted that lots of research methods are available and said Ofwat will look for a "robust, balanced and proportionate" evidence base from companies which goes beyond the willingness to pay approach. Minor decisions demand less in the way of back-up research that more major ones; where the findings from different research approaches prove conflicting, companies should "dig deeper".

Workshop "in the spirit of the Marketplace for Ideas"

Ashley encouraged companies to innovate and not be afraid to fail: "Innovation can fail, we recognise that," he explained, suggesting in this eventuality companies should explain to Ofwat what they learned despite the failure. He added that in light of this risk, they may want to use "tried and tested" methodologies as well as more cutting edge ones. He concluded by acknowledging Ofwat's demands as "challenging" but shared his belief that companies were "on track". The workshop itself perhaps demonstrates the industry is grabbing the bull by the horns.

Making a start

Those were useful insights, but those at the coal face of customer engagement could be forgiven for still not knowing which way to turn. A useful starting point is a paper providing an overview of research approaches produced by London Economics and Britain Thinks and available from think tank Sustainability First. It points out that approaches split broadly into the quantitative (stated preference and revealed preference techniques that reveal values and behavioural experiments which test responses) and the qualitative (deliberative research and qualitative panels that can demonstrate the principles driving thinking).

It relates: "As a general rule of thumb, quantitative approaches will provide organisations with robust findings which are statistically significant and therefore representative of a population as a whole (and/or selected sub- sets of a population). Their findings offer quantified data that can be scalable and from which wider inferences can be made. Such quantification can be used to make comparisons and to feed into cost benefit analysis (e.g. stated preference) and to design customer programmes and policy interventions (e.g behavioural experiments). Qualitative approaches can provide an in-depth exploration of views and a more considered input on a particular issue. Such approaches can give insights into why people think the way they do and how individuals or groups might approach complex trade-offs."

The paper stresses: "No single approach works in isolation to provide a full 'solution-set' to issues with the levels of complexity >

likely to be explored. Rather, the ideal would be to use a range of different techniques and build up a fuller and more robust picture of stakeholder and customer opinion." Exactly how a research approach is chosen or a combination selected will depend on the organisation's objective. The paper provides a checklist of practical questions that could help nail this down case to case.

However, discussion at the workshop soon threw up some specific considerations for water companies that need to be taken into account as they plan their engagement for PR19. These included:

- How to make engagement engaging: a number of participants described water as a low interest area for customers. Ece Ozdemiroglu, founding director of environmental economics consultancy Eftec, suggested companies should only engage once they have a clear idea of what information they need, should draw lessons from other sectors who have a similar problem; and use fresh mechanisms such as social media, icons and emojis. Another participant remarked that water and diamonds are opposite commodities: despite its "essential good", water is low value while diamonds are high value. "But there are times when water turns into diamonds; when people don't have water, it becomes the most important thing in their lives." He suggested customer sentiment in such situations could be systematically captured to reveal how much people truly value water.
- How to capture the views of customers in vulnerable circumstances: managing director Rob Sheldon said his company, researcher Accent, refers to this group as the "seldom heard". He observed there would be a lot more activity at PR19 directed at capturing the views of this group.
- Affordability: Sheldon noted too that the affordability agenda underpinned the business planning process at PR14 while companies also, separately, undertook streams of work on social tariffs. "If we put the two together, there maybe opportunities to invest in long term resilience," he commented.
- Future generations: Building on the theme of resilience is that of intergenerational equity and funding long term outcomes. CC Water's senior policy manager Steve Hobbs flagged this up as a key challenge for PR19.

Stated preference

Stated preference research, which involves asking customers about what choices they would make, is deeply ensconced in regulated industries including transport, utilities and communications. At the last water price review, stated preference willingness to pay research was the bedrock of water company business planning. Ofwat's Water 2020 position has challenged this dominance, but won't lead to the demise of WTP. Participants at the Thames workshop were largely in agreement that stated preference will remain the cornerstone of customer valuation at PR19 but must be both improved and supplemented by information revealed by other methodologies.

Stated preference has a lot going for it. It can be done consistently, at large scale and it can deliver information that is comparable company to company or group to group. However it suffers from being artificial in essence, removed as it is from real world choices. Companies also need to be careful in compiling research content and question phrasing. Accent is a world leader in the technique. Sheldon advocated the sector adopt best practice for stated preference work at the next price round. Researchers should try to replicate real world situations where possible and build in behavioural insight biases. Risk should be designed out and language and concepts kept simple. Sheldon illustrated his point with the comment that "only 10% know what 10% means" and has described some of the concepts and language used in research 15 years ago as "frightening".

Nevertheless given Ofwat's position and learnings from PR14, total reliance on even best practice stated preference alone won't be acceptable. It will need to form part of what Hobbs referred to as "a basket of evidence". Most likely it will need to kick off the research process and then other methods be used to check the most important, most contentious and most questionable findings, before acceptability research completes the process at the end.

The alternatives

A key attribute of the Thames workshop was that it offered curious water companies tasters of many of the alternative approaches that are out there for them to ponder. Delegates were able to visit four of ten break out sessions run by research experts. These covered a range of aspects including: pushing the boundaries of the more traditional alternative techniques, making interactions more engaging and informative, engaging with different groups, and looking at more novel and innovative methods. There were sessions on the following.

- **Revealed preference methods**, run by Eftec's Allan Provins. Revealed preferences techniques concentrate on observing real choices customers make. Provins offered some examples: scrutinising customer appetite for water softening in hard water areas by looking at customer spend on softening products such as filters and descalers, and at hard water related contacts and complaints; establishing customer appetite for bathing water quality investments through scrutinising beach visiting behaviour and the factors influencing those choices. He noted revealed preference had limitations of its own – for example, it couldn't gauge sentiment on potential activities only real ones, and results can be group specific and hence difficult to multiply across a whole customer base. But he said targeted use of revealed preference, particularly for material items, could be very valuable and could help companies to a greater depth of understanding about customer choices. In addition, the point was made a number of times throughout the meeting that companies could do a lot more with operational data and customer contact data that already exists to extrapolate customer preferences, and should exploit newer datasets too including from social media and in time from behaviour in the non household retail market.

> **Risk should be designed out and concepts kept simple...only 10% know what 10% means**

- **Co-creation**, run by John Isitt and Gary Nolan from researcher Partners in Creation. This is a methodology for innovating and to bring customers into the heart of company decision-making. It typically takes the form of a structured workshop in which 15-50 people participate, some customers and some from the company. There is a "golden question" to answer, usually a problem to solve. Over a three to six hour period, a systematic process is followed to explore the question and co-create a solution. No- >

ESAN: THE CONSUMER VOICE IN THE REGULATION OF ESSENTIAL SERVICES

While water companies are busy planning and commissioning their PR19 research activities, bigger questions on customers in regulated industries were debated last month at a conference organised by the Essential Services Access Network's chair Roger Darlington. This looked at how the consumer voice can be better heard in the regulation of essential services. Speakers evaluated three models.

The consumer voice within the regulator. A key benefit of being "in the tent," as Sue Lewis, chair of the Financial Services Consumer Panel put it, is the ability to shape regulatory policy in consumer interests from the get-go. She said the Financial Conduct Authority brings her panel policy in its formative stages for input. Chris Holland of the Communications Consumer Panel added that there is also the matter of regular access to regulatory decision makers and other key stakeholders.

Keith Richards, chair of the Civil Aviation Authority Consumer Panel, said the key question to ask is: is the consumer interest being brought to the fore? His view was that consumers will benefit from regulators listening to a trusted considered voice – perhaps more that a loud, shouty one. In the case of the CAA, his group had helped get the themes of choice, value and fair treatment for consumers "embedded" in regulatory thinking.

However, being in the tent does come with strings attached. Lewis remarked that publicly, her voice was "muted"; there was a sort of "deal" whereby complete frankness of opinion in public did not sit comfortably with access to privileged information. She said she had to be both careful to guard her independence and "careful not to bite the hand that feeds you – at least, not too hard".

Nor was there any getting away from the fact that low or no budgets are limiting (see table).

The consumer voice outside of the regulator. CC Water chair Alan Lovell summed up the sentiment of this group of speakers when he asserted CC Water had "achieved much more from being outside" of Ofwat than it could have done if it had stayed in. In those days, he said the forerunner of CC Water had been a "Cinderella service". As a standalone statutory customer body, it had made "tremendous progress" – including driving complaints down since 2005, securing £20m+ rebates and compensation for customers, contributing to the provision of social tariffs at 19 out of 21 water companies and bringing Ofwat's "over generosity" to shareholders at the expense of customers to the attention of policymakers.

Chair of Transport Focus Jeff Halliwell emphasised the strength of having "no conflict of interest…no duality – we just represent the passenger". Lovell concurred that detachment from the regulator allowed real independence; referencing CC Water's recent intervention on a domestic retail water market which called Ofwat's optimistic attitude to account, Lovell said his organisation could offer "clear views which are not always in the direction Ofwat is seeking".

Allied to complete independence is trust, which is crucial on many levels. Champion here is Citizens Advice. Stew Horne, principal policy manager for energy regulation at Citizens Advice, said it is "highly trusted" by the media on one hand and by the public on the other. At 97%, Horne said its "recognition metrics are amazing", that its services had been used by four in ten people and that its website was visited by 100 people an hour. Not only does this mean lots of people are getting help, but also that Citizens Advice is able to reap a "rich amount of data" and, from its national network of bureaux and phone helpline, "amazing real time information on what's going on on the ground".

As the table shows, the consumer bodies outside the regulators are significantly better resourced than those within, albeit form different sources. Not only does this fund expert, full time staff, but crucially independent research which the consumer bodies use to establish and champion customer views.

The consumer voice within the regulated company. This model has only emerged in the last few years, starting in water at the last price review. UK Regulators Network director Claire Simpson explained that her organisation has embarked on a project to examine the merits of provider-led challenge with a view to publishing something next year.

As a practitioner, Anna Bradley, chair of Southern Water Customer Advisory Panel, called for an end to one of the accusations that has repeatedly been levelled against consumer voices within regulated companies since the model emerged: lack of independence. She urged: "It is really important that everyone in this room stops arguing about who is the most independent. I don't know anyone in consumer advocacy who isn't." She accepted that there was a need to address the appearance of a lack of independence though, and said this could be done through transparency and clear documentation – for instance through challenge logs.

Bradley said proximity to the company offered the benefits of regular access at board level, and, providing you can develop "the right kind of relationship" – one of openness and honesty – access to privileged information. The model could even lead to positive "cultural impacts" on the company, which could be crucial to embedding customer focus.

Finally, she said the model offered a good opportunity to supplement national regulation by making provision for local or regional variation. This in turn could drive up benchmarks for regulatory use. "It is difficult to raise standards by diktat from the centre," she observed.

Conclusion? A number of speakers remarked on the fact that there is no single solution; no one model or methodology that should stand without the rest. Citizens Advice's Stew Horne said a multitude of voices was a good thing and that the challenge fell on government and regulators to engage with the complexity.

BUDGETS AND FUNDING

Representative	2015/16 budget/spend
Communications Consumer Panel	£369,000
Financial Services Consumer Panel	£492,000
CAA Consumer Panel	£36,000
CC Water	£5,724,000
Citizens Advice	£3,000,000 energy; £2,346,000 post; £730,000 cross sector; £648,000 CA Scotland
Transport Focus	£5,039,000 bus and rail; £1,033,000 road

Source: ESAN conference paper

lan cautions that companies do not always get the answer they expect, but that the technique "always works".

Talking to customers about comparative information, run by Gary Muncaster of research and strategy consultancy Populus. Muncaster shared tips emanating from some work his company had carried out for one of the water companies using comparative data sourced from the upgraded Discover Water site (see box). It found customers have an appetite for comparisons, such as company to company comparisons or changes over time. However that having access to comparisons made little difference to respondents' priorities – these remained drawn primarily from their own experience. Muncaster's advice to companies planning to use comparative information in their PR19 engagement included: to

We are opening ourselves up to a higher degree of variability

use accessible measures like percentages rather than industry specific ones like Ml/day; to keep the language simple; to use no more than ten comparators and around half a dozen metrics; bar charts were the most popular form of data representation, with the company in question clearly highlighted in a different colour from the rest; and to do a qualitative trial before rolling it out.

Resilence and consumers, run by Water UK advisor Martin Hurst. Hurst shared some insights on engaging customers in depth on long term issues or emotive issues such as around investment to deal with flooding or coastal erosion. These included: experts aren't trusted – get an independent facilitator in; visualise as much as you can – for instance, show a picture of a queue at a standpipe rather than talking about water shortages; give people real investment choices; refer to how a situation might affect a respondent's children or grandchildren, rather than in terms of years in the future; and tailor techniques and methods to different age groups.

The other sessions available were:

- Gamification, run by Alan Waldock of the Future Cities Catapult
- Survey participant engagement, run by Accent's Rob Sheldon.
- Happiness and wellbeing assessment, run by Daniel Fujiwara of social impact analysis specialist Simetrica.
- Engaging those with mental disabilities, run by Suki Westmore of MIND.
- Behavioural economics, run by Kat Slater and Liz Barker of Behaviour Architects.
- Latest thinking on identifying and measuring customer preferences, run by Andrew Bryan of the Henley Centre for Customer Management.

Triangulation

There is clearly plenty for water companies to go at in terms of broadening the richness and reach of their customer engagement work. Having a more varied toolkit to hand is both an exciting prospect and one that could feel a bit overwhelming. Certainly it provokes many questions. How much weight should companies put on different sources of evidence? At what point should a firm bring all its research together in its business plan? Should it provide supporting evidence for each performance measure, or each customer group, or what? What happens when the results of cross-checking research conflict? With a greater array of evidence available to both individual companies and across the industry, there is clearly a risk of inconsistency of analysis. One of Sheldon's words of warning was that we are "opening ourselves up to a higher degree of variability".

Towards the end of the day, the workshop discussed whether guidelines for approaches to triangulation are needed and if so how they might look. The development of guidelines would raise another question: how far should triangulation be one size fits all, verses how far should triangulation techniques as well as engagement methods differ company to company. The sentiment seemed to be that principles would be better than a rule book.

CC Water will be working over the next few months on pulling together its thoughts on how different datasets could best be brought together, Smith reported. Ofwat meanwhile has emphasised that engagement choices sit squarely with companies. Senior director of Water 2020 David Black told The Water Report Ofwat had given a clear steer that it expects "a fresh approach" and that "I don't expect to set out explicit guidance". He added however that there may be something more to say on "what good might look like".

One participant at the workshop fed back from a discussion at her table that deeper engagement and more varied information on customer preferences would not detract from the fact that water company experts (scrutinised by CCGs) would have to make a judgement call at the end of the day about how to translate all the data they have gathered into business plan practicalities. So it seems there will still be a place for what she termed "hunch-based" decisions in a world where customer engagement and information are of better quality. TWR

DISCOVER WATER - PHASE 2

Late last month, the multi-stakeholder water information website www.discoverwater.co.uk which launched in July with industry-wide information went live with new company comparative data. Customers and other users are now able to see how their company performs relative to its peers on 24 metrics, "the top line things that really matter to customers," explains Water UK's head of policy Rob Wesley. These include key performance measures on water quality, leakage and sewer flooding. This adds to aggregate England and Wales sector level data on around 60 metrics which is also available on the page.

Wesley describes the site as "a critical tool for PR19". Not only does it make industry information easily accessible and digestible for interested customers (the site has managed to retain its simplicity and usability while offering the greater depth of information), which in itself will help build trust through transparency. But companies now have a reliable, multi-stakeholder backed resource to draw on to show customers how they are doing relative to their peers – for instance, to aid discussion of whether improvements should be sought out.

Direct comparisons between companies are not easy on all metrics, particularly since PR14 tailored incentives for companies through ODIs. Wesley explains the industry has worked through the challenges as "across the board, all companies recognised this was the right thing to do". The site is defined as a sector wide strategic dashboard, "not a substitute for individual company communications" according to Wesley, and as such it provides links to company websites should users seek more detailed explanation of the results presented.

Discover Water will be updated regularly as information becomes available and looks set for further enhancement going forwards. Wesley concluded that he is not aware of a comparable resource anywhere in the world.

MERGER OR ACQUISITION?

If Severn Trent's bid for Dee Valley beats off competition from Ancala Fornia, there will be boundary issues for business retail to deal with as well as consolidation matters.

As *The Water Report* went to press this month, the takeover "battle" for Dee Valley between Severn Trent and investment management firm Ancala Fornia remained more of a skirmish. The water company's 1825p a share offer on 25 November was recommended to the Dee Valley board at the end of November and that looks likely to end the bidding. But Severn Trent's path to the prize is not entirely hurdle free.

During the offer period, following Severn Trent's first bid, Ancala bagged a 4.5% stake in Dee Valley from Chelverton Asset Management. This added to irrevocable undertakings to vote in favour of Ancala that the investment firm struck with a number of key shareholders at the time of its first bid in October: AXA Investment Managers UK with a 25.5% stake and Aviva Investors Global Services with a 9.6% holding. Together these arrangements give Ancala a near 40% grip on the voting shares in Dee Valley.

The irrevocable undertakings cease to be binding should a bidder make an offer 10% above Ancala's in the case of AXA and 15% for Aviva, without a prompt counter bid from Ancala to exceed the new bid. Severn Trent's first offer was exactly 10% greater than Ancala's – hence the investment manager's 1p-a-share counter bid. Severn Trent's latest offer is 7% more than Ancala's so the commitments, according to Ancala, are still in force.

Under takeover rules, Severn Trent has to win 75% of the votes – by value of the holdings of the voters attending shareholders' meetings (scheduled for January) to decide the outcome of the takeover bid. Nevertheless Severn Trent has suggested that the vote may go in its favour. The firm told The Water Report the terms of the the irrevocable commitments "do not expressly require the relevant shareholder to vote at the Severn Trent meetings." There are other considerations that may influence Dee Valley shareholders and possibly add risk to Severn Trent's progress with the bid. Because of its existing interest in the sector, Competition and Markets Authority clearance will be required. The competition regulator opened the first phase investigation into the latest bid on 29th November. There is a 27th January deadline for a phase one decision. Ancala, naturally, is eager to emphasise that its bid triggers no such regulatory hurdles.

A proposal that could cut both ways with shareholders considering where to place their vote emerged when Severn Trent unveiled its bid for the FTSE Fledgling-listed Dee Valley. Severn Trent announced that it: "Intends to maintain a separate Welsh licence for Dee Valley and, subject to regulatory approval, intends that the whole of Severn Trent's business in Wales be regulated under Welsh government policy." In a subsequent statement it said it "will be considering how best to manage the non-household retail business post acquisition".

Welsh Government policy is currently not to extend business retail competition beyond the existing 50Ml consumption threshold. Severn Trent's comments seem to suggest that all of its Welsh customers – current ones and those gained through the Dee Valley acquisition – would be governed by that policy. This would not affect Dee Valley businesses who under current arrangements will not have access to a sub 50Ml market. But Severn Trent's existing Welsh customers will, given their supplier is mainly based in England. The company could be anticipating developments in the Wales Bill (see box) that could obstruct Wales-based businesses' participation in the new water retail market.

Meanwhile local MPs are concerned that the Severn Trent deal would result in job losses. Ancala has said its offer would preserve Dee Valley as "run by staff situated locally within the community who will be incentivised to deliver excellent customer service to that community".

In a statement accompanying its latest revised offer Severn Trent said: "Severn Trent will bring its expertise and considerable financial strength to support the business, its customers, employees and pensioners". Severn Trent's chief executive officer, Liv Garfield, added the acquisition represents an opportunity for the firm to "apply its successful operating model for the benefit of customers across an enlarged asset base, in a neighbouring geographic area."

Cost benefits arising from the deal during AMP6 will be shared with customers. TWR

By Trevor Loveday

WALES BILL LATEST

New powers relating to water will be devolved to the Welsh Government and the Welsh Assembly under changes to the UK government's Wales Bill, which is currently being scrutinised by the Lords.

At present the UK government, in the shape of the Welsh secretary, can block legislation on water-related issues in any legislation made by the Welsh Assembly. Those powers will be replaced by a legal agreement between the Welsh and UK governments. The Welsh government has been calling for the devolution of these powers for some time.

The details of the proposed agreement have yet to be published. Government minister Lord Bourne promised that a protocol setting out the terms of the deal would be produced by the time the Bill gets to its report stage in the upper chamber. No date for that stage has been set yet.

When the issues were discussed in the Lords earlier in November Welsh peers lined up to insist that the National Assembly would have the full power to authorise or reject any proposal for the construction of new reservoirs in Wales. Peers also made it clear that Ofwat should be fully accountable to the National Assembly in respect of the functions the watchdog exercises in relation to Wales' water supply and sewerage issues.

Welsh peers want to ensure that at least one Ofwat board member is a joint appointment between the Welsh secretary and Welsh administration ministers and that the regulator is required to produce an annual report for both Welsh Government ministers and the Welsh Assembly.

Some Peers want the protocol to be included on the face of the bill. At this stage Lord Bourne has only guaranteed that the existence of the protocol will be referred to in the legislation.

A WORLD OF SIMILARITY

Black & Veatch's global water president Cindy Wallis-Lage says there is considerable consistency on water challenges place to place, and that collaboration could improve the situation for the benefit of all.

Cindy Wallis-Lage is president of Black & Veatch's global water business. She leads a team of 2,600 spread across 100 offices worldwide. You sure can tell. Speak to her for even a few minutes and the depth and breadth of her experience becomes obvious. She peppers the conversation with references from all around the world, and effortlessly identifies contrasts and comparisons from place to place, drawing on her nearly 30 years with the company.

Wallis-Lage is in fact responsible for all the company's water and wastewater-related business strategies, development and operations on a global basis, encompassing engineering, construction, consulting and design-build ventures. She is an authority on water reuse, wastewater treatment and biosolids. She also serves as a member of Black & Veatch's executive committee and board of directors, and has held board and committee appointments at a number of global water bodies including the Water Environment Federation and the International Water Association.

Given all of this, what is top of her to-do list? "Strategy – that's my number one," she says. "And providing leadership. That's not necessarily about coming up with ideas; it's about being an enabler, seeing how ideas align with the broader context, deciding which ideas would make a difference. An idea could be great, but it may not be in the right time and place."

UK challenges in context

This publication is as guilty as anyone of tending towards the insular; of being so devoted to the detail of the UK water sector that we don't always stop to think about the bigger picture and about water as both a world resource and a global challenge. So what can Wallis-Lage tell us about the UK water situation, relative to that of the rest of the planet?

Well, we are not alone in our struggles for starters. "At the high level, the challenges are very consistent," Wallis-Lage says. "Population growth, urbanisation, the growth of the middle class, cities in dry areas, customer expectation of 24/7 safe reliable water, globally changing climates – though the stresses and strains of that vary." She continues: "Ageing infrastructure or a lack of infrastructure is another common problem". Collectively, these problems are complex and overlapping. Mitigating them will require intelligent, integrated solutions. "If you focus on just one, you miss the complexity," Wallis-Lage adds.

She explains that yet further complexity comes from the need to approach these common challenges in different ways place to place, according to the local context – adapting to matters such as the political and regulatory framework; leadership styles; the nature of the key players; local culture; and acceptable funding streams. "Every system has pros and cons," explains Wallis-Lage. She comments of the UK, with its unusual privatised water company arrangements, that the model cares relatively well for base infrastructure and has driven forward efficiency. "But I'm not sure it always drives forward thinking and holistic collaboration…it's complex to promote connectivity in an environment based on competition."

Guiding principles

It is possible to identify some principles in Wallis-Lage thinking that could be beneficial for UK water companies and other stakeholders as they grapple with the many and varied challenges facing the industry today.

Collaboration: Wallis-Lage believes collaboration is vital in developing solutions, flexibility and nimbleness. Data needs to be shared within and across organisations and nations. Infrastructure industries are interlinked and face common challenges but these challenges are often considered in silos rather than holistically, and by different entities separately.

She relates an example of good practice on collaboration that was cited at an eight-strong expert panel discussion held in Singapore recently. It was of a water leader from the Netherlands who stepped up after Hurricane Sandy hit the US to create a new conversation between stakeholders – public water suppliers, NGOs, regulators and so on – on taking a joined up strategic approach to resilience, rather than just looking to repair damage and rebuild infrastructure. Another example she cites is of the deputy assistant director of the US EPA who accepted the Agency had been a barrier to better outcomes and consequently initiated a multi-stakeholder dialogue on how it could move towards becoming an enabler rather than a blocker.

Closer to home, Wallis-Lage suggests water companies should advance how they collaborate with the supply chain, particularly to share risk and reward through creative alliances. "Risk and reward sharing will drive progress collectively," she explains. "If all the risk sits on one side, you get protectionism." She speaks highly of the Thames Water alliance Black & Veatch is involved in, where all partners' incentives are aligned with those of the water company.

She also suggests water could benefit from more extensive collaboration with sectors such as power and telecoms. "They could bring different thinking to the table as they have to solve parallel challenges."

Innovation: Wallis-Lage has the stark message that "business as usual no longer exists, if it ever did". While we need to make use of our past experiences, we also need to shed the arrogance of thinking we can plot a precise roadmap for the future. "It's about putting your best solutions forward, considering the long term value and re-evaluating as you go, not aiming for a single end point," she explains.

She also believes we need to be more open minded and less guarded towards change. "Innovation is often thought of as a risk. But it can also de-risk a business." She points out that change does not need to be radical to be powerful; in fact that evolution may be a better bet than revolution. "If you change course by 1º, it may seem like you've barely moved but you end up in a completely different place. 90º disruption can have a negative effect, and can even prevent future beneficial change." That said, she also argues we must embrace the possibility of failure when we try something new, rather than letting fear of it "cripple and inhibit us". The key, she says, is to take what we can from the experience and hold it in mind for the future: "The real failure is failure to learn," she advises.

She cites an examples of innovation well managed: GE – a very large company that has managed to stay nimble, innovate and gain market share.

Leadership: Wallis-Lage believes innovation and the delivery of better outcomes must be led from the front. She reports two worthy examples: Denmark's environment minister, who drove a change of mindset in his country by insisting on full cost recovery for water services through a system of carrots and sticks; and Coca Cola's director of environmental sustainability Paul Bowen who pushed shareholders to understand water was the company's biggest risk as it is the main ingredient in its beverages. Coca Cola now has a mature and measurable water sustainability programme.

Communications: Wallis-Lage values the importance of customer engagement and the benefits it can bring. She offers an even starker comment in reference to the role of communications in a drought scenario: "Communications will help you or will kill you. That includes lack of communication, wrong communication, even the wrong words."

Principles to practice

Drilling down below high level principles, the Black & Veatch boss highlights two practical top line items that she thinks demand particular attention in light of the water challenges we face. The first is alternative water supply. Too little water, and water of insufficient quality affect many geographies and there are many alternatives to consider, including desalination and reuse (she adds the latter is "close to my heart"). Industrial reuse and use of alternative supplies to irrigate non edible crops are established but only deliver a small amount of what is needed. Direct potable reuse has been tried – for instance, in Namibia – and Texas is "looking at it". But much more work needs to be done, particularly around consumer engagement to address perceived health issues and risk. "We need honest communications on this, we shouldn't sugar coat it," she says, adding: "We need to strive for thought leadership on alternative water supply."

Second, Wallis-Lage emphasises our need for far better information to underpin asset management. "There is a significant lack of knowledge of water assets and their health," she explains. "People talk about 'headroom' and stranded asset risk and so forth, but unless we know what an asset's true capacity is and what risk it is carrying, we can't define its headroom or accurately assess the case for new build. And until then, we can't prioritise investment." She anticipates that more widespread and sophisticated data analytics will be key – "and that applies everywhere". TWR

UNBUNDLE OF JOY?

Does disaggregation create or destroy value? A report from November's Indepen Forum.

Mergers and de-mergers are part and parcel of corporate life. But with new markets opening or set to open in water and legal/regulatory positions on consolidation and disintegration evolving, it is perhaps a particularly pertinent time to scrutinise the value of unbundling in water. November's Indepen Forum – a monthly gathering of infrastructure sector big hitters – asked whether disintegration tends to create or destroy value, or does it vary case to case?

Up for an unbundle

Many participants at the meeting made the case that de-mergers deliver value. One speaker identified two problems with integrated monopoly businesses: that they carry a monopoly of management and a monopoly of ideas. Unbundling, he said, will introduce new ideas and new management teams, which in turn can benefit both shareholders and customers.

Another argued the true benefit of unbundling is "absolute management focus" on the individual businesses, and leadership teams in each case that are completely clear on what they need to deliver. He felt unbundling should not be regarded as 'disintegration', rather as absolute focus on delivering business imperatives.

Such contributors cited a number of examples to back up their views:

- Every demerger British Gas has gone through has released value.
- National Grid sold off what it considered to be its weakest gas distribution networks (GDNs) but subsequently those businesses thrived.
- Hyder, which failed around the turn of the millennium, gave rise to two successful single business companies – Glas Cymru and Western Power Distribution.

However, others cited limitations to unbundling. One said that diversity could be a strength and a way to manage risk; another that there could be a tipping point at which the benefits of focus are outweighed by the drawbacks of working in a silo.

A balanced view came from a participant who pointed out different models have strengths and weaknesses and hence that you can't reach a blanket conclusion. Another Forum member pointed out that things are not so black and white anyway: in some instances, disintegration leads to the emergence of new models of integration.

Shareholders in control

On the matter of who should drive unbundling decisions, shareholders emerged from the discussion on top. One speaker argued shareholders were best placed to weigh up the economies of scale and scope benefits that derive from being a larger entity, against the harm that integration may do to competitive prospects. Moreover that corporate activity of this nature carries the risk of unintended consequences for customers; a situation that is amplified if the change is forced by external drivers and if generic solutions are shoe-horned onto companies.

However she specified a number of caveats to the position that shareholders should be in the driving seat. These included that regulated companies should not be allowed to innovate off the back of the balance sheet or use regulated funding streams for flurries into competitive markets, and that should a shareholder-driven break up harm customers, regulators must intervene effectively. She explained that meant promptly and with analysis-based not policy-driven outcomes in mind. She added in discussion that the UK doesn't have a great track record on this: competition authority inquiries frequently take years to complete and the remedies/outcomes they impose can be questionable.

A second speaker agreed with the position and argued that shareholders had two core roles to perform in this context: ensuring a high quality management team is in place, and ensuring there is alignment between short term actions and long term business goals. One Forum member went further to say we should put our faith squarely in markets, including to the point of allowing markets to correct themselves when failures occur. He was supported by another who urged regulators to believe in markets rather than to intervene to solve problems – though another participant pointed out that there was little political support for this position: in fact he said a number of pro-market regulators had been "hounded out" of their positions by politicians keen to weigh-in.

For their parts, company management teams should be ready to embrace change as and when their shareholders will it. A number of contributors also emphasised that companies need to realise the value of the data they are sitting on and to free up analysis of it to drive better outcomes.

Role of the regulator

So, if shareholders should be in the driving seat, what role might regulators play? In his summing up at the end of the discussion, the chair suggested regulators might create the catalyst for change and show "guts" in allowing companies to innovate, stepping in only to "unstick the sticky bits". He observed they might be unwise to assume they can address problems with ready made solutions.

There was discussion of the general matter of whether regulators are simply too risk averse to embrace innovation, given innovation carries risk. One participant pointed out today's environment encourages risk-averseness: shareholders can be intolerant, customers are demanding and pricing issues are sensitive. She added though that such an environment made it "all the more important that [regulators] occupy that space" and observed that a regulator that is truly afraid of innovation is in the wrong job.

One contributor reported "encouraging signs" in water on this front; in fact nothing short of a "sea change" that could support disruptive change. He said this was driven by Ofwat's recent recognition that it should encourage the expression of disruptive change from others but should not be the architect of that change itself; and early indications of incumbent companies' consequent acceptance that they are unlikely to get conventional (and often inefficient) approaches past the regulator any longer.

Another member said he would be eager to learn more about the "sandbox" regulation that was mentioned by one of the speakers – essentially, for regulators to encourage testing and piloting of innovations in a meaningful way. However, another contributor countered that it is political expediency, not cool regulatory assessment, that typically holds sway where unbundling decisions are directed externally. TWR

South East Water tops information quality league

There have been significant shifts since last year in the rankings now published annually by Ofwat on the quality and trustworthiness of water company information.

South East Water was the only firm to emerge with a completely clean slate, where every aspect assessed by the regulator either exceeded or met expectations. It consequently rose from a middle ranking performer to the top category of assurance: self assurance, whereby Ofwat trusts it to self-assure the information it publishes beyond the minimum requirements that apply to all companies. South East was joined in the top category by two other newly promoted companies: Severn Trent and United Utilities.

Last year's self-assured firms, South West Water and Affinity, moved down to join the ranks of the bulk of the industry in the targeted assurance category. This group will be subject to targeted prescriptive assurance requirements, which are designed to protect customers.

The number of companies in the bottom grouping doubled. Yorkshire Water and Southern Water joined Bristol and Dee Valley in needing the assurance requirements for all information they are required to publish to be prescribed, according to Ofwat. This entails them publishing their assurance plans for all information in advance of reporting, including in some aspects seeking independent external assurance. Southern came lowest in Ofwat's ranking; the regulator identified two aspects that were of serious concern, relating to outcomes and casework.

In the short term, the new positions will affect companies' assurance planning activities.

Ofwat added it will take account of the quality of companies' information at PR19. "Companies that wish to secure 'enhanced' status, and benefit from a streamlined process, need to demonstrate high quality information and assurance." It added though that all was not lost for those in the lower groups: "All targeted and prescribed companies now have the opportunity to improve their status before this process begins." This is in part due to a change in approach planned for next year's assessment. The stipulation that companies which are in the prescribed category must stay there for at least 18 months will be removed.

Ofwat's assessment relates to information that companies published during the 2015-16 regulatory year but also includes their 2016-17 charges information. It is the second exercise the regulator has performed under its new company monitoring framework (CMF), which it developed last year. Last time around, firms were categorised based on the quality of their assurance at PR14. This year, the assessment has deployed the formal company monitoring framework methodology.

Promotions are based on meeting expectations in most, if not all, assessments, with examples of exceeding expectations and good practice. Demotions follow company behaviours that have led to a reduction in the trust and confidence stakeholders can place in them. The assessments are grouped into three categories:

- Data assurance – the financial monitoring framework; 2016-17 charges schemes assurance; the final 2010-15 reconciliation; and the financial information within the annual performance report.
- Wider assurance – outcomes; principles of board leadership, transparency and governance; assurance plans; the risk and compliance statement; and the data assurance summary, as well as company responses to recent targeted reviews.
- Casework.

TESTING THE QUALITY OF INFORMATION FROM WATER COMPANIES 2015-16

Company	Change since last year	Category
South East	Up	Self-assured
Severn Trent	Up	Self-assured
United Utilities	Up	Self-assured
Sutton and East Surrey	Same	Targeted
South West	Down	Targeted
Affinity	Down	Targeted
Northumbrian	Same	Targeted
South Staffordshire	Same	Targeted
Dwr Cymru	Same	Targeted
Anglian	Same	Targeted
Thames	Same	Targeted
Portsmouth	Same	Targeted
Wessex	Same	Targeted
Bristol	Same	Prescribed
Dee Valley	Same	Prescribed
Yorkshire	Down	Prescribed
Southern	Down	Prescribed

INTERIMS SEASON

We are covering companies' interim reports as they happen on line at www.thewaterreport.co.uk. Sign up to our free email bulletin for a weekly round up of these and other industry news items by emailing subs@thewaterreport.co.uk. Among the highlights of the reporting round so far was Thames Water's announcement that it received £99m through the sale of its business retail book to Castle Water. Its non household customers are being transferred to Castle in tranches, starting with a small number and scaling up.

Resilience Action Group gets going

Land management post-the Common Agricultural Policy, resilience research and qualitative metrics for resilience are among the first projects the new Water and Wastewater Resilience Action Group (WWRAG) will work on, Water UK has announced. The group was convened following a recommendation from Ofwat's independent Resilience Task and Finish Group. It will consider best practice on resilience across the water sector and provide guidance where it considers innovation and thought leadership is lacking.

The WWRAG is chaired by University College London's Professor Tim Broyd, who is also president of the Institution of Civil Engineers. Its members include water company representatives, Ofwat, CC Water, environmental groups, the Association of Drainage Authorities, the UK Water Partnership and Systems Thinking.

EC probes NI water charges

The European Commission has decided to investigate the Northern Ireland Executive's (NIE) policy that domestic customers of Northern Ireland Water should pay no specific charges to the utility. The NIE pays £280 million a year to NI Water to meet some of the cost of domestic water supply. Business customers are charged directly.

Under EU rules, water customers are meant to be charged for water use. In Northern Ireland the administration claims domestic customers do because they pay a regional rate.

The European Commission has opened a so-called "pilot case" to look at the issue. Essentially, this is a way for the Commission to establish whether EU rules are being correctly applied. It allows for the Commission and member states to resolve any conflicts without resorting to infringement proceedings.

The Department of Agriculture, Environment and Rural Affairs said it could not comment on the detail of the case.

CC Water: Be more ambitious on leaks

Leakage from supply pipes in England and Wales fell for the first time in five years – by over 1% – but the Consumer Council for Water (CCWater) has called for further improvement.

Following its most recent *Delving into Water* report, published last month, the consumer watchdog called on some companies to up their game on leaks and help reduce the 121 litres of water wasted every day on average by each household. Chief executive Tony Smith said: "Leakage remains an important issue for consumers and it can dampen their own motivation to save water if they think their water company is not pulling its weight. Some water companies need to show more ambition in beating – not just meeting – their leakage targets."

Other findings in the report included:

- High consumer satisfaction with many aspects.
- Most companies are performing well in many key areas, including increasing assistance for customers struggling to pay, metering, drinking water quality and tackling sewer flooding.
- Written complaints from customers fell for an eighth successive year – but ten water companies bucked the trend and reported a rise.
- Just over half of water companies made an improvement in the time consumers were without a water supply due to a burst supply pipe or maintenance work.

Half of South East Water up for sale

Two Canadian stakeholders are looking for buyers of their combined 50% stake in South East Water at a reported price of some £200 million.

Pension-fund manager, Caisse de Dépôt et Placement du Québec (CDPQ) is disposing of its 37.5% share in the water only company and Desjardins Employees Pension Fund is selling its 12.5% holding, according to reports.

CDPQ bought a 50% stake in the water company in 2010 from fund manager Hastings Funds Management for £165 million before selling a quarter of that to Desjardins.

Canadian bank RBC and consultant, PwC are running the sale.

CER tells Irish Water it must cut costs by 20%

Irish Water has been told to reduce its costs by 20 per cent because they are "significantly higher" than those in comparable utility companies, according to the country's water regulator, the Commission for Energy Regulation (CER).

The watchdog has reduced the amount of money Irish Water can spend by €156m for 2017 and 2018, and says the involvement of local authorities in day-to-day operations could be "impeding" the utility's ability to reduce costs.

CER said it would allow the company to collect €1.85bn to operate and upgrade the network over the next two years. The utility had requested €156m more.

On capital expenditure, some €1.29bn will be allowed. On the operations side, Irish Water sought €1.52bn, and was allowed €1.4bn.

The regulator noted that the water network was previously operated by the country's local authorities who still had a role under Service Level Agreements (SLAs) negotiated between the councils and the utility. "This operating model may impede Irish Water's ability to deliver cost reductions in the short term as it will take time to implement a unified approach and common systems and processes," the regulator noted.

It concluded that: "Irish Water's costs, inclusive of SLA costs, are significantly higher than those of established utilities in other jurisdictions. The CER expects Irish Water to drive efficiencies at a level that is broadly comparable to those achieved by other utilities elsewhere."

The regulator said it expected Irish Water to deliver "efficiencies of circa 20 per cent within its base controllable operating expenditure over the period from the start of 2015 to the end of 2018."

EPA BLASTS IRISH URBAN WASTEWATER TREATMENT RECORD

Ireland is neither spending enough or spending fast enough to deal with the environmental and public health issues surrounding urban waste water treatment. That's the conclusion of the Republic's Environmental Protection Agency (EPA) in its latest report on the subject, covering 2015. The watchdog said "significant funding was required for waste water treatment if pollution and health risks were to be avoided".

The report highlighted that:

- 142 large towns and cities complied with EU waste water treatment standards during 2015, while 29 failed.
- Raw sewage was still being discharged from 43 areas. The planned delivery of treatment plants at half of these areas has now been delayed, by an average of almost two years.
- Reported annual investment in infrastructure since 2014 has dropped by 40 per cent from the average levels during the previous decade.

The EPA wants Irish Water to prioritise work at the 29 large towns and cities which have so far failed to meet mandatory EU waste water treatment standards required by a 2005 deadline. Also of concern are the 43 areas still discharging raw sewage and the 13 collection networks which require significant upgrades to meet EU standards and prevent the loss of wastewater into the environment. Work is also needed to protect six popular bathing beaches and critically endangered populations of freshwater pearl mussels.

Consolidation continues with Pennon/South Staffs

Having successfully merged Bournemouth Water with South West Water in April, Pennon Group is now seeking clearance for a non household retail joint venture with South Staffordshire Group.

Under a plan announced last month, the two companies intend to combine in an 80:20 joint venture (with South Staffs as the junior partner) which will operate as an enlarged Pennon Water Services. PWS was created as part of a wider Pennon Group restructure earlier this year, and already combines the NHH operations of South West Water and Bournemouth Water.

The companies said the new JV will deliver a combined customer base of 180,000 accounts, making PWS the fourth largest retailer in the non-household retail water market, with 8% market share. Existing in-area trading names will be retained, and Pennon's Source for Business brand will be used as the out-of-area national name. The tie up will give PWS a foothold slap bang in the middle of Water Plus territory (the South Staffs operation) and in Anglian Water Business territory (the Cambridge Water operation).

Pennon Group has already said it is using the national footprint and order book of its waste operation, Viridor, to explore opportunities for its NHH retail arm, starting in Scotland. Chief executive Chris Loughlin explained: "Viridor is very strong in Scotland and there have been benefits in being active there in terms of relationships with all of the procuring local authorities. They don't only procure waste services, they also procure water services across their various activities."

Loughlin said of the new deal: "We've made no secret of our ambition to develop our presence in the water market as we prepare for retail market opening next April. We're pleased to team up with the South Staffordshire Group, combining our expertise and creating a bigger business retailer, with excellent growth potential."

The JV is the latest consolidation in the non household segment, spurred on by low margins and the need to keep cost to serve down. It follows United Utilities' tie up with Severn Trent as Water Plus (now complicated by Severn's bid for Dee Valley); Business Stream's purchase of Southern Water's business customer book; customers of Thames and Portsmouth now in Castle Water hands; and a longer standing partnership between Wessex and Bristol as Water2Business. Other JVs are understood to be in the offing. TWR

INFORMATION ON TAP

Gemserv is gearing up to launch a Scotland on Tap equivalent in England.

Scotland on Tap is the website WICS operates to help non-household customers switch. It offers simple, clear advice on how the market works, the potential benefits available and enables customers to directly contact all or any of the licensed providers they are interested to hear more from. By all accounts, it is highly regarded and well used.

Next month, Gemserv will launch an equivalent for the English market, England on Tap. The company, which specialises in making markets work for everyone's benefit, was integrally involved with the opening of the Scottish market, and believes there is a clear requirement from both customers and suppliers for a website in England which fulfils the role and purpose of www.scotlandontap.gov.uk. Gemserv's business development manager Nick Bath is working on the launch. He reports that retailers are "keen to have – in fact they expect – something more or less the same" in England.

Open Water comparison

Ofwat has revamped the Open Water website and this too offers customers basic market information and a supplier listing. However, Bath reports that after discussing details with Ofwat, it became clear to Gemserv that the regulator saw their role as "providing the basic information required to stimulate the market rather than to offer all the functionality" – specifically, the Open Water site does not put customers in touch with potential retailers. Following discussions with market participants, Gemserv confirmed an appetite for greater functionality and has invested in www.englandontap.co.uk.

The site seeks to complement Open Water by offering users the opportunity to contact some or all retailers at the point they are showing interest – customers won't have to leave the site to link to different retailers' pages one at a time or hunt around online for contact details. Instead, as with Scotland of Tap, there will be an enquiry form for interested customers to complete, and Gemserv will send leads direct to the retailers selected by the customer. It will not hold or store this information itself.

The other differentiator Gemserv identifies is that it will actively promote the site through various channels including search engine optimisation, ad words, targeted advertising and relevant events and exhibitions. It has already kicked off its event marketing, appearing at the Major Energy Users' Council's October roadshows and the All Party Parliamentary Water Group's November Innovation event. Bath adds that marketing will be persistent, not a one-shot, pre-launch affair. "It will be constant and ongoing," he explains.

Funding

Scotland on Tap is funded by retailers as part of their licence. But a different funding model is required for England on Tap given the site will not be administered by the regulator. Gemserv stresses that it is not undertaking the project as a standalone commercial venture, so is not looking to substantially profit from it. Rather, it is looking to help facilitate the water market as it facilitates many other markets in the UK – from smart metering to micro-generation. As well as core involvement working with WICS on the Scottish water market, the company has steadily contributed to the development of the English market, working with companies such as Open Water, Ofwat and DEFRA in a variety of ways. It has also published a string of thought leadership documents to help the market along, the latest of which came out in October (see box).

Gemserv has committed to provide universal coverage of all suppliers in the market on England on Tap. It will list all of those licensed by Ofwat in a changing, randomised order to ensure the playing field is level. Those who want to benefit from customer enquiry leads, and to enhance their listing with a short company description and logo, will pay a flat fee regardless of their size or market share for a 12-month contract with England on Tap. Bath says the bulk of the funding raised will be used to pay for site curation and will be reinvested in marketing and promotion.

Gemserv has been engaging with stakeholders throughout November and will continue this through to mid-December when it plans to start signing up partners. Bath is optimistic about getting a full house of retailers on board.

The site itself is being developed externally and is due to be delivered to Gemserv by mid-December for user testing. Content upload from partners will begin immediately after that and dedicated pre-launch marketing will also begin. The site will be soft launched mid-January and there will be an official launch event at the end of that month. Bath stresses though that feedback from both users and suppliers is very welcome and, that if needed, changes or improvements to the site will be considered for phase 2. TWR

BUSINESS CUSTOMER OPPORTUNITIES

Gemserv's latest water thought leadership paper discusses *Opportunities for business customers to benefit from full water market opening*. It seeks to help customers make an informed choice, and covers the pros and cons of various switching options. It also draws lessons from the Scottish market experience, tracing the evolution of new entry, margin growth and market share change. It, along with previous papers, can be found at http://bit.ly/29YDEbl

THE POLITICS OF COMPETITION

At the annual Beesley water lecture last month, Nick Fincham scrutinised further water competition through a political lens – and found it wanting.

Is more water competition politically attractive? Not particularly, according to Thames Water's strategy and regulation director Nick Fincham, who gave the annual Beesley Lecture on water last month. Sharing a personal rather than company view, Fincham argued that the critical factor to consider as greater use of markets in water is pondered is how this would play when "viewed through the political lens". He explained this is because there has been a progressive shift of power towards central government over the past two decades.

Fincham set out his reasons for arguing more water competition is not politically attractive:

Household retail: Domestic switching would not sit comfortably in the May government's "Britain that works for everyone," he argued. Not only are the potential gains small (net benefits of around £8 off the typical annual bill, plus the prospect of dynamic efficiency gains from bundling). But given disconnection and prepayment meter installation are not options in water, those in debt and those who may struggle to pay could be either frozen out of the market by suppliers unwilling to carry the risk, or end up paying higher prices to cover that risk.

Fincham elaborated: "Now it may well be that a social tariff (or tariffs) could be introduced to mitigate the risks associated with unforeseen consequences. But – frankly – given the size of the gains compared with the levels of discount generally considered necessary to tempt customers to switch suppliers…the general lack of enthusiasm expressed by consumer groups (including CC Water's recent contribution to the debate, and a lukewarm reception from many Customer Challenge Groups), it might not seem such an attractive political proposition."

Upstream markets: These are work in progress already as Ofwat progresses its Water 2020 vision. But, said Fincham, "the question facing government is whether it really considers there to be significant benefits from upstream reform of the water industry. And I suspect the answer – absent broader reforms, e.g. of the abstraction regime – is probably not."

He reported Ofwat's numbers: estimated benefits of water and bio- resources markets of around £800m in both cases, calculated as a 30 year NPV. This translates as an average annualised saving of just over £40m per annum. "So – if Thames Water represents a fifth of the industry – this would be a saving of £8m out of annual revenues of £2bn. In other words, a price reduction of around 0.4%. The effect – if expressed in terms of the annual bill – is that the saving would amount to around £1.50 a year off a typical annual bill of £380, or about three pence a week."

Fincham accepted dynamic benefits may yield more but equally pointed out that greater market complexity and perceived risk could have knock-on effects for the cost of capital. "Out of a typical annual bill of around £380, about £75 relates to the cost of capital. What this means is that if this reform were to give rise to more than, say a seven basis point increase on the cost of capital (from 3.6% to 3.67%), the analysis implies that these particular reforms would destroy value rather than create it."

Wider backdrop: Citing Brexit, Trump's election, and the many unforeseen shifts among the ranks of our own politicians over the past year, Fincham indicated there are more pressing matters to be dealt with in the national interest than water competition. And even if the industry is in sight, that "the politicians who have this decision-making responsibility may question whether the competition is indeed the most relevant question facing the water sector. For example, questions of resilience and reliability of water and wastewater services may well take priority."

Government creep

The Thames director also talked through the logic of his argument that the transfer of decision-making responsibility on matters related to competition has shifted from the independent regulator to government. He traced this through: BIS's 2011 economic regulation principles, which raised the matter of democratic legitimacy being needed for sensitive trade offs; the 2014 Water Act, under which Ofwat became required to act "in accordance" with the government Strategic Policy Statement rather than to "have regard" to it; and the recent household market review in which Ofwat has accepted "fully and openly that the policy decision resides with government before waiting – like any other affected party – to hear the decision". Fincham pointed out that this was "a world away" from the "hand in glove" working between senior DTI and Ofgas officials to introduce competition into the UK gas industry in the 1990s.

Marshall's response

The respondent at the lecture was Eileen Marshall CBE, a member of Ofwat's Advisory Panel and with a distinguished career in regulation. She disagreed with the "whole thrust" of Fincham's paper, arguing it was simply making the case for the status quo. "I do not support the retention of the status quo," she said, pointing out that upstream and non household markets are already legally provided for; that she hoped the government would opt to open the domestic market, and that an abstraction market was close.

Marshall accepted that how far the " regulatory promise" on RCV should be honoured was "controversial" but referred to gas industry developments and competition authority rulings. These, she said, pointed to the fact that the regulatory contract struck at privatisation was "not necessarily frozen in time". TWR

INDUSTRY COMMENT

THE TIMES THEY ARE A-CHANGIN'

But by how much? PA Consulting scopes out alternative futures for water.

The successful launch of shadow operations for the introduction of non-household (NHH) retail competition is a clear demonstration of the sector's determination and ability to adapt to and embrace significant change. Indications for PR19 suggest an even greater industry shift is approaching, with the introduction of upstream competition, licence modifications, new price controls and the transition to far more thorough customer engagement anticipated. This may, in turn, be followed by the introduction of household (HH) competition.

Given these challenges and future uncertainties, companies need to assess the different ways the market may evolve and review their strategies to ensure they can optimise their position in the future water market environment.

Future scenarios

One effective way to address uncertainty is to use scenario planning to explore potential developments.

We have considered scenarios for the water sector, using the period to 2022 as a timescale. This is sufficiently distant for the PR19 changes to have become embedded, but close enough for reasonable assumptions to be made.

Any scenarios must consider the implications of two critical developments. The first is the balance between regulatory and market drivers. The introduction of NHH competition marks an important step towards a self-regulating market. The scenarios need to explore whether this evolution will continue or whether a perceived need for continued strong regulation will limit market activity.

The second key consideration should be the extent of aggregation and disaggregation within the industry. There are two aspects to this. Firstly the extent to which the industry functions will disaggregate into separate companies, for example Ofwat's Water 2020 consultation already suggests a future market-based approach to sludge treatment and disposal and water trading (see report, p22). Secondly the extent to which companies themselves will merge and consolidate.

We have created four scenarios that reflect these aspects and the different degrees of change they could bring as shown in the diagram.

Steady as she goes

In this first scenario, although the regulator pushes ahead with changes, these are largely incorporated within the current mode of operation or structure of the industry and most companies opt to remain consolidated, albeit through legally separate entities.

Companies operating in each region continue to comply with their wholesale requirements and now offer HH services through legally-separated companies (associate retailers). Whilst some have left the retail market due to limited margins, most continue to operate and have now merged their NHH and HH services into a single retail service provider.

There has been some limited market consolidation and re-aggregation, but in general, other than the continued evolution of retail, there is minimal change. In the absence of significant market activity, the regulator remains highly active in protecting consumers.

This scenario could arise as a result of a lack of switching following the 2017 NHH market opening, or through low margins in the household market. These factors would deter entry to new retailers, or mean the few that enter the market cannot maintain a successful business. On the wholesale side, the introduction of Water 2020 is far less radical than might be anticipated and largely incorporated within current structures.

Know the ropes

In this second scenario, the key factors driving change are scale and speciality. Competition in both retail and wholesale has had an impact, but there is a tendency towards aggregation and consolidation as the financial markets drive a series of mergers and acquisitions to maximise market impact and achieve economies of scale.

In retail, there has been a significant shift in the provision of services to an active and thriving market as a result of lessening regulatory pressure, enabling a more pronounced responsiveness to competition and customer choice. However, initial expansion in the market has now resulted in a series of mergers and acquisitions as retailers unable to adapt to this new and competitive market, or operate within the available margins, have exited.

In wholesale, services continue to be supplied by current providers, but the introduction of upstream competition has tended to drive consolidation and increased scale. There is a trend for companies to maintain all elements of the value chain, albeit as separate legal entities where required. The early mergers, such as South West Water and Bournemouth Water have proven successful and encouraged the regulator and CMA to view consolidation positively.

This scenario is very similar to the path followed by the energy industry. On the retail side, an early flurry of small new entrants gave way to consolidation as they were largely either acquired or failed, leading to the emergence of the "Big 6" energy suppliers. On the distribution side, 14 regional companies consolidated down to six major providers of network services.

Dead calm

Following the formalisation of Ofwat's Water 2020 vision, the value chain has been further disaggregated under the third scenario, with water trading and sludge treatment and disposal entering a new "competitive" market.

Wholesalers have accordingly separated their water and waste treatment capabilities into separate, associated, businesses. Many have taken measures to better understand their processes and associated costs for providing these services and, to an extent, to commercialise their own approach.

However the disaggregation has proven challenging as the crucial need to balance technical, commercial and consumer factors, has created the need for continued strong policy and regulation to protect consumers. This has consequently limited the required freedom to act purely competitively. This lack of incentive for new companies to attempt to adapt and compete, combined with geographic challenges, means there has been very limited uptake in the market.

On the retail side, early activity has given way to a stagnant market as available margins prove a barrier to competitive pressures and the market stabilises around established retailers.

A compliant but ineffective market may be observed if control over the services is too restrictive or margins are too low to generate interest from within or outside of the current market.

Uncharted waters

This scenario outlines a radically different industry. In this world the remaining monopoly is a consolidated water and sewerage distribution network, which sources services from a myriad of highly specialised providers based on the best deal. These providers compete within the water sector to offer their particular service or skill, alongside offering related services in other sectors. Upstream, fundamental change such as the introduction of catchment managers may emerge.

Some undertakers move their traditionally regulated assets into non-regulated businesses, which are then operated on their behalf through a number of these specialists as sub-contractors. Other specialists run their own multi-sector sites and actively compete for business.

The introduction of this business model and the subsequent efficiencies and innovation realised through commercialisation of the value chain has driven substantial disaggregation. For example, a traditional sewage treatment works is now split into a number of separate industries which each focus on getting the best performance from their particular part of the process. These may include:

- *nutrient removal – there is a new focus on nutrient recovery from the water component of wastewater as materials become increasingly scarce, in particular phosphorus;*
- *energy production - sludge is now viewed as a product to be used and companies combine it with waste through co-digestion to maximise income and energy output;*
- *sludge recycling – an ever increasing demand from agriculture drives a market in delivery of nutrient-rich soil enhancer and top soil to local landowners.*

Wessex Water provides an example of how this scenario could work. They have operated a functionally separated sludge treatment company since 2009. This successfully competes to treat sludge at its own sites rather than sites operated by the integrated utility.

This scenario relies on a significant shift in the sector, which could be realised if appropriate policy and sufficient incentives are in place to drive the market. This may include removing some of the barriers to entry, for instance revising the common carriage arrangements for sewerage, and the introduction of an independent contracting entity to buy and sell upstream services.

> The regulator has a very difficult line to tread

Planning for the future

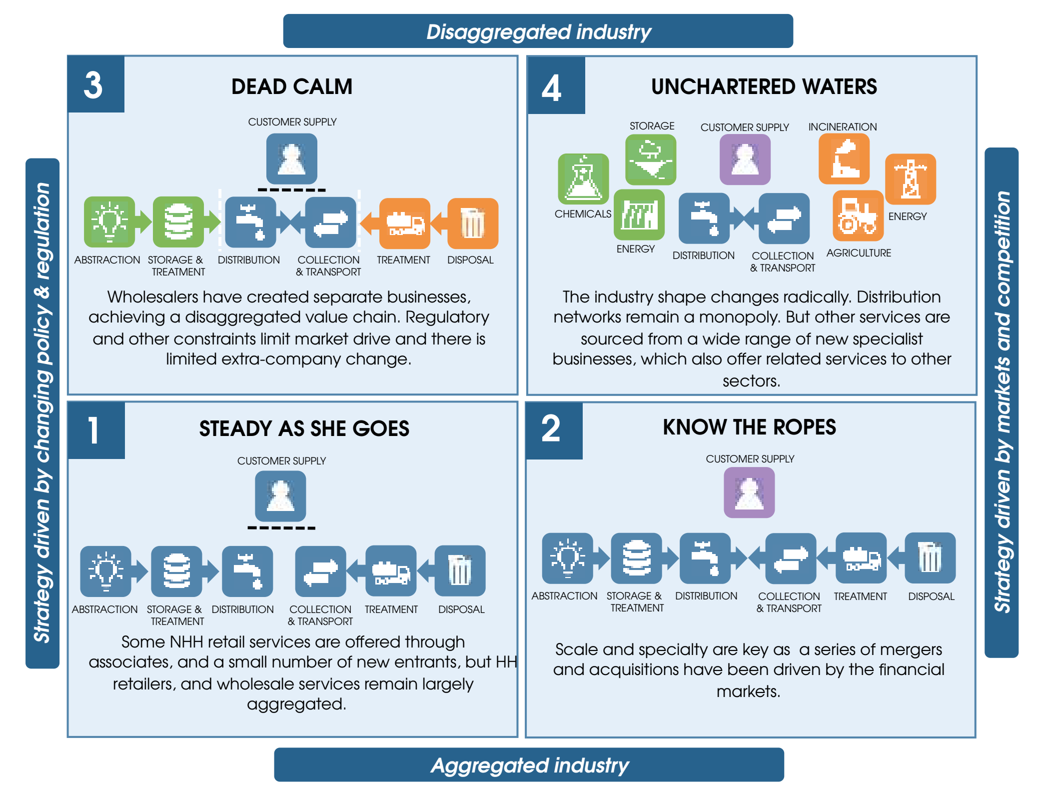
These scenarios are by no means an exhaustive account of the way the industry may develop but highlight some of the broad changes which may emerge. Companies will need to develop their own scenarios both to test their views of what the future may look like and consider what they would prefer that future to look like. They can then use that insight to understand their desired role in that future and whether they intend to take measures to influence the outcome.

Similarly the regulator needs to consider scenarios such as these, which could be beneficial for consumers and which would be detrimental. For example, Know the Ropes represents a path taken by the energy industry. This has generated benefits for consumers, but also been subject to continual debate leading to a CMA enquiry over the last few years. The regulator should examine this and ensure lessons are incorporated. In achieving the right balance between regulation and market drivers, the regulator has a very difficult line to tread between preserving the excellent quality and delivery record of the industry and establishing the basis for radical change.

The water industry has an exciting if uncertain future ahead. However those companies which undertake effective scenario planning will be able to take a more strategic view of that future and adapt their plans, making them far more likely to succeed. TWR

By Laura Frudd and Ted Hopcroft, water experts at PA Consulting.
www.paconsulting.com/water

POTENTIAL SCENARIOS FOR 2022



SMALL BUT PERFECTLY FORMED

SES Business Water MD Giuseppe Di Vita and his team are unfazed by being one of the smaller NHH retail players and believe their tried and tested billing system gives them strength that many don't have.

There has been a lot of speculation about how water only companies will fare in the business retail market. On one hand, they often smash customer service and complaints leagues, and tend to have strong local identities which could help with retention. On the other, they are little known out of area, unlikely to have deep enough pockets to splash the cash on mega-marketing, and in some cases may be challenged on working capital. SES Business Water, the newly minted non household retail arm of Sutton and East Surrey Water, believes it has hit on a sweet spot.

Managing director Giuseppe Di Vita provides the back story: the board decided to compete following a strategic assessment with external consultants and with the backing of newish (since 2013) shareholders who have an appetite for growth. Jeremy Downer, market reform delivery director, recalls that one consideration when choices were being mulled over two years ago was that "there was not a zero cost option" – i.e. even companies which opt to exit have to fork out considerable sums on preparation activities. The result was that the board decided to "set up a fledgling business set on organic growth".

Now legally separated, SESBW is a sister company to the wholesale incumbent. The company plans to play on its dual strengths: of being both experienced – its website proclaims it has been "Proudly providing water and services for over 150 years"; and fresh – Di Vita says: "We've got a new entrant mentality and are working as a start-up, with a different culture from the water business."

On the "established" front, the managing director says SESBW is "low risk – a good, solid bet" and offers "heritage, security and confidence". The company's trump card here is its billing system.

Giuseppe Di Vita

One month without payment and it would be difficult; two months and you could go out of business

Downer explains SESBW has "entirely replicated the system we had at Sutton and East Surrey" – a system which is already capable of e-billing, with 15% of household and business customers opting to be served that way. An EDI product is due for release shortly. SESBW sales director Bill Clarke adds: "We could have gone to market and bought a system we'd never used before, as some others have – but we've got something we know works."

Di Vita picks up the theme, pointing out that non payment or a billing problem is the "single biggest risk for a retailer". He continues: "One month without payment and it would be difficult; two months and you could go out of business". He expects to see some water retailers fall down on this.

Meanwhile, on the start up/new entrant front, Clarke says SESBW is agile, responsive and offers "super-fast decision-making – we can deliver answers in hours". Of its ten-strong team, eight are new recruits, while the management team itself reflects the company's blend of old and new. Downer is well known in the industry, having worked at Sutton and East Surrey formally since 2001 "and as a consultant to it for ten years before that". Di Vita's former role was as group sales and marketing director at Npower, where he headed up a team of 1500. He joined Sutton and East Surrey just over a year ago to develop and then lead SESBW. Clarke meanwhile is coming up to a year with the company from a consultancy background, most recently at Water Audit Services.

So can a company really have the best of both worlds? Di Vita considers: "We have lots of the benefits of new entrants – maybe not all, maybe there's a trade-off: we may not be quite as agile, but there's not much of a difference. And we're starting out with 14,000 customers and with no stress about our billing system. I wouldn't swap it."

Rebranding

The new brand was chosen because it references the company's heritage without being geographically restricting – SESBW intends to compete nationally. The logo is intended to look friendly, modern and simple. The team ruled out any rebrand options that didn't scream water. Di Vita comments: "Building brands in the B2B space is notoriously difficult, and with the margins low, we dismissed anything that didn't reference business water."

Planning and communications preparations went on behind the scenes for some time before the brand was publicly released in early autumn. Clarke reports it is being used with in-area customers now and that this in itself hasn't caused any increase in call rates.

Di Vita rejects the argument that size is against SESBW in the national marketplace, saying that in his company's case it is "not relevant". The ultimate parent companies of both SESW and SESBW are two of Japan's largest companies, Sumitomo Corporation and Osaka Gas, who amongst other interests serve 10m utility customers. SESBW's working capital is therefore "most appropriate" and "we're not going to price every deal to take account of our fixed costs". Clarke adds that the wave of rebranding activity that has swept across the sector in recent months has done smaller and newer players a favour. "The biggest threat to us is not being included in the party [by customers who only look at large retailers' offerings]. Thames was there [as a known brand], but is Castle? United Utilities and Severn Trent were there, but is Water Plus? All this movement has created empty slots that we can fill."

Organic growth

SESBW counts large users including Gatwick Airport among its starting customer base of 14,000, which stretches to some in Scotland. It acquired a licence to trade there in April. It has proactively upped the game for these customers since taking over retail functions from the regional incumbent with an eye to retention, and has its sights for growth set squarely on the organic route. It is interested in customers from any segment and of any size, but in line with its comments on the importance of payment, will only take on "those who pay the bill", Di Vita comments. He elaborates: "We've got to be choosy or our existing customers will suffer."

The company's customer proposition rests on a couple of key principles. First, transparency. Di Vita says he is happy to lay bare his margin to customers as it is "so thin". SESBW is in fact offering an innovative Wholesale Tracker tariff, whereby customers pay the wholesale price plus a menu-based fee for retail services. This way, they only pay for what they want. "We won't flog you stuff you don't need," he clarifies. For those who do need, a suite of services is available, ranging from single activities to a whole management package. Collectively they tend towards the objective of reducing cost by reducing consumption.

The second principle is simplicity. Di Vita points out that unlike in energy where customers have to manage wholesale price risk, wholesale water prices are regulated. This makes the buying decision much simpler and, he says, suggests there is no reason to wait to switch. "Will the market get more or less competitive in 12 months? I don't know, but I think the savings on offer could be less as there is hunger and determination right now from companies like us. And you won't be able to claw back any administrative savings you might make if you switched now."

The market

With just a few months left before go-live, SESBW is keen to crack on with business under market arrangements as they stand. But it flags up a few aspects it will be keeping a close watch on. These include:

- Data mechanisms and quality: Downer observes it is entirely new for the industry to consider and use customer and site data in the way that is planned, and as such "we are holding our breath". The company seems to expect there to be substantial data quality issues, especially for customers who have separate water and wastewater suppliers and those who live in company to company boundary areas. With its access to the central market system, SESBW is in fact offering water users – whether or not they are or intend to become its own customers – a service to interrogate, verify and improve the data held by CMOS on their premises.

Bill Clarke

The wave of rebranding activity that has swept across the sector in recent months has done smaller and newer players a favour.

- Wholesale tariffs: Downer argues that the way wholesale tariffs are constructed, determined and published limits retailer flexibility. He notes they comprise more than RPI+K as they factor in the likes of under and over charge recovery risk and Outcome Delivery Incentive rewards and penalties. "They have been designed to ensure wholesale company revenue recovery. They haven't been well thought through from a retail perspective."
- Customer awareness: Clarke feels it has been a case of "too little, too late" on raising customer awareness of market opening, particularly as the sector starts with a relatively disengaged customer base.
- Regulation for the market: Downer points out that Ofwat's choices and effectiveness as a regulator in the competitive space will be critical. For instance, it must allocate costs appropriately between wholesalers and retailers and, within the retailer grouping, between associated retailers and new entrants – for example, for any customer awareness campaign. It must also ensure customers are protected without overburdening suppliers who are trying to exist on a thin margin. Di Vita questions: "A low margin may drive efficiency and innovation, but will it drive competition?" TWR

Jeremy Downer

Ofwat's choices and effectiveness as a regulator in the competitive space will be critical.

NEWS IN BRIEF

WSSL update: Affinity for Business has become the latest firm to secure a WSSL from Ofwat. Meanwhile, a WSSL application has gone in from a new player, incorporated in July under the brand The Water Retail Company. Its director is Lord Redesdale of the Energy Managers Association.

NAV review: Ofwat has issued an invitation to tender for consultants to assist its investigation of how the market for New Appointments and Variations is working. Stakeholders have flagged up that the regime is slow and costly despite refinements the regulator has made in recent years. Ofwat noted the scale of the market is "modest" – only eight appointees have entered and 68 NAV sites have been granted.

Panel plans: Plans for the enduring Panel are advancing. Nominations were taken last month for candidates to sit on the Panel, which will oversee changes to non household market rules.

Autumn Statement: There was some expectation in the industry that chancellor Philip Hammond may shed light on the government's thinking on opening the household market to retail competition in his Autumn Statement. This was not to be. Hammond did announce a £23bn National Productivity Investment Fund for innovation and infrastructure, though there was no specific mention of water infrastructure.

Streaming ahead: Business Stream has opened a new office in Worthing accommodating the expert team which will transfer from Southern Water as part of the acquisition. It is also recruiting more staff at its Edinburgh headquarters.

Wholesale charging rules finalised

Ofwat last month published the final version of the rules that will govern how wholesalers in England and Wales charge retailers for wholesale water and sewerage services. It made only minor amendments to its draft policy, which was published in August, and these were by and large points of clarification.

Consistent with its wider strategy, the regulator will not design or specify wholesalers' tariffs but has proposed a rule requiring wholesalers to consider general charging principles when setting their charges. Wholesalers have been told to publish "indicative wholesale charges" – an outline of what they expect their primary wholesale charges to be – three months in advance of their final decisions. The notice period is six months if wholesalers are planning to significantly alter their charges.

To increase confidence in indicative and final charges being accurate and fair, Ofwat is seeking board assurance from wholesalers; for wholesalers to engage with business customers in developing their tariffs; and for an impact assessment to be produced where charges will increase by more than 5% on the previous year.

Wholesale rules comprise around 90% of the costs business customers will pay. The rules have been developed in light of guidance issued by the UK and Welsh governments. Ofwat said it sought for its rules to drive transparency. "Our approach will also help retailers to drive efficiency in the wholesale market as they compare (and question) the wholesale charges that have been proposed."

As part of this drive, wholesalers must:

- Identify the different wastewater services charges that they offer to retailers – for the treatment of trade effluent, foul water, highway drainage and surface water drainage and clearly state what concessionary surface water drainage discounts may be available and how these discounts may be accessed.
- Include information on both primary charges – typically involving meter based annual charges and/or volumetric charges for water and/or sewerage – and non-primary services – e.g. charges for disconnection, meter testing, provision of fire hydrants and pressure tests.
- Publish wholesale charges for eligible customers with special agreements.

Ofwat consults on MAC and WRC

Ofwat is consulting on some of the final elements of the new legal and regulatory framework that will govern the incoming non household retail market. Respondents have until 16 December to respond to two code consultations: one on the Wholesale Retail Code (WRC) which sets out the relationship between wholesalers and retailers and how the market will operate; and the other on the Market Arrangements Code (MAC), which sets out the functions of the Market Operator together with the process for modifications.

Both codes have already been subject to extensive and ongoing consultation. As part of this finalisation process, Ofwat is seeking views on further changes to the code change process set out in the draft MAC, with a view to ensuring the process is robust, effective and compliant with industry licence conditions. Specifically, four issues are in the spotlight:

- Ofwat being able to set a timetable and/or process for the code Panel's considerations in certain circumstances.
- Requiring the Panel to always provide a recommendation to Ofwat, to avoid the code change process stalling before the regulator makes a decision.
- Adding provisions to allow the Panel to review and revise its final report, if necessary to correct any deficiencies or to address queries.
- Adding provisions requiring the implementation of any changes to the MAC.

The WRC paper is a formal consultation on the restructured WRC. The regulator said it sought feedback from respondents on whether any further changes are needed before the code comes into effect in April 2017.

Shadow: the end of the beginning

Wholesalers, retailers, Open Water partners and others gathered in London late last month to celebrate the successful launch of the shadow non-household retail market, at a party co-hosted by MOSL and PA Consulting. Speakers on the night stressed there was plenty more yet to do but praised achievements to date and the efforts of all parties.

Referencing Ofwat and DEFRA's intent to see further change in the industry, MOSL's chief executive Ben Jeffs noted "We are at the end of the beginning, rather than the beginning of the end." He anticipated a smooth "no song and dance" go-live in April when "the money starts to flow and customers start to switch". Jeffs also thanked DEFRA's Holly Yates for her contribution as she moved on from the Retail Market Opening programme.

Ofwat's Adam Cooper said market opening brought "a huge shift internally" for the regulator as well as the industry: it had to learn how to be a market regulator.