APRIL 2015

THE WATER REPORT

POLICY | REGULATION | COMPETITION

Open for Business?

Business Stream chief executive Johanna Dow says tight margins, lack of wholesale commonality and a playing field that is not overtly level don't make for a welcoming English market.

COMPETITION WATCH

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- Eligibility: who will be able to switch and who won't?

INSIDE ELECTION PROSPECTS | SOCIAL TARIFFS | SOUTHERN'S WRIGHT ON UNIVERSAL METERING

THE WATER REPORT COMPETITION WATCH

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EDITOR'S COMMENT

Don't write off national affordability idea

While there is no absolute consensus among water companies on the key plank of the Labour Party's water policy – a national affordability scheme – the concept has seemed generally unpopular. There is already a national social tariff in WaterSure, and companies broadly welcome being able to tailor other assistance to the specific needs of their customers. That many have only just succeeded in introducing social tariffs after years of hard work will obviously weigh against enthusiasm for a change too (see feature, starting p6).

Labour hasn't exactly done much to win industry support for its policy either. It has provided little detail and has consistently framed its national affordability commitment in inflammatory, language – in particular, blaming companies for offering little in the way of social tariffs (conveniently ignoring the DEFRA-stipulated need for customer buy in).

But rhetoric aside, would a new national affordability scheme stack up? Obviously this depends on exactly what it entails. An uncompromising approach that rode roughshod over regional circumstances and demographics, that ignored the complexity and that created losers as well as winners (were existing schemes to be replaced) would be very unwelcome. But handled well, some centralised aspects could be beneficial. After all, one in five customers struggle to pay their bills and far fewer receive assistance of any kind.

Were the national affordability scheme to pursue the line of cross subsidised social tariffs, for instance, there could be blanket adoption of a low level of cross subsidy, say £2. This would free companies – particularly those in deprived areas where gaining customer endorsement has proved difficult or impossible – to offer a basic level of assistance.

Companies could be free to redistribute this £2-a-customer resource as they saw fit, in line with customer priorities and local circumstances. They could also retain the option of consulting customers on a higher cross subsidy threshold. An added benefit would be that we all could end up paying less to cover bad debt, if more customers could be encouraged to pay a little of a smaller bill rather than nothing of a larger one.

Other national affordability scheme options might include an enhancement of WaterSure, or some other offering that could sit alongside rather than replace existing arrangements.

So should Labour find favour with the electorate on 7 May, the industry should put the party's provocative rhetoric behind them and work collaboratively to develop a national affordability scheme that actually helps.

Karma Ockenden, editor,
The Water Report

Feedback, comments and suggestions very welcome.

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

ELECTION FEVER COOL FOR WATER

Water is mercifully slipping under the radar of party politics as the election nears. Nevertheless, there are some direct and indirect issues to keep an eye on.

It's been a few months since floods or drought have hit the headlines, and water is a long way from the top of the public mind as it prepares to go to the ballot box next month. In fact, save for from Labour, water has barely had a mention in the election campaign. Right now, it's simply not a political issue.

This can be considered something of a triumph for companies and Ofwat, who have together managed to keep prices – and hence political scrutiny – down and investment up, and who are moving in the right direction in treating customers more fairly across the board. Even a sideways glance at the energy sector, where political interference is rife, shows what a blessing being largely off the political radar is.

Speaking at the Future of Utilities conference last month, ScottishPower chief operating officer Keith Anderson described the prospect of further political interference in his industry as "a colossal risk". Fearing the worst, last month we saw the emergence of a Utility Markets Policy Group through which energy suppliers, networks and customers are banding together to make mutually agreeable policy suggestions to preempt ill informed or rash decisions being made by the next government. The Major Energy Users' Council-led group does have water members, but the immediate priority is energy and carbon policy.

Water companies too are keen to avoid knee-jerk reactions as the new government beds in. It's not about preventing change, just ensuring change is thoroughly considered and well managed. For instance, at least one group of companies is known to be collaborating on research with a view to contributing to the development of policy to implement Water White Paper objectives, rather than just waiting for that policy to hit them.

While some will argue the delivery record of outgoing water minister Dan Rogerson has been unambitious, his administration has been a reasonably safe pair of hands and has made significant progress in some areas, notably through the passage of the Water Act 2014.

Leaning left

Obviously the party that poses the biggest risk – or opportunity, depending on your point of view –to the water status quo is Labour, or perhaps more realistically a Labour/left leaning partnership potentially featuring the SNP and the Greens. Labour's water team has turned down the volume on its bashing of the industry since shadow environment secretary Maria Eagle's conference speech last autumn. This failed to find the voter gold that Ed Milliband struck the year before when he dragged energy into the spotlight with his price freeze promise. But they key ideas Eagle hinted at in that speech remain party policy.

Top if its list is a national affordability scheme, though what exactly that would entail and how it would work remain elusive. Without any detail, a national scheme could be anything from an enhancement of WaterSure to an extensive and centralised, tax-funded assistance programme, though the latter looks unlikely. Complicating the picture is that fact that, since Labour promoted the policy last autumn, the majority of water companies have launched their own social tariffs (see feature, p6-10). So whether these would be scrapped, somehow aggregated, or supplemented with a national scheme is unknown.

The two other main planks of Labour's water policy are a new sustainability duty for Ofwat and ensuring companies pay a "fairer" share (more) tax. The regulator is understood not to object to the concept of a sustainability duty, though it would of course need to see the detail before it could properly consider its position.

More tax would inevitably be popular with the public at large and unwelcome to water investors, though clearly the sector would not be alone in taking the blow, given Labour's policy is to tax big companies more across the board. Exactly how water companies would fare in reality on tax under a Labour-led government given their high net debt levels (which can be offset against profit) and the existence of capital allowances (which benefit the industry enormously given its high investment levels) remains to be seen.

Other issues

Aside from the Labour policies mentioned, the immediate water priority for whoever is in power after 7 May will be successfully ushering in the non-household retail market on time for April 2017. Given that the idea of giving businesses more choice in this way had cross party support throughout the passage of the Water Bill, and the extremely short time available to prepare the market, retail reform seems likely to be largely unaffected by the election result. The new government will have far more scope to influence abstraction reform (slated for the next parliament) and following on from that, upstream reform.

Beyond those obvious issues, developments water folk might want to keep an eye on include:

- Will DEFRA survive as a standalone department? True, its fate has long been speculated upon, but given the austere times there could be more appetite for rationalisation.
- Implications for water of changes in the energy market. Of particular importance here will be shale policy (see box, Government priorities); any implications for water competition from the outcome of the CMA energy referral; and regulatory arrangements. Labour has pledged to scrap Ofgem.
- Flood risk management policy – how heavily will water companies be involved?
- Broader environmental policy and its impact on water quality and resources (see box, Government priorities)
- Infrastructure investment. Deputy director of HM Treasury's Infrastructure UK arm Geoff Baldwin told Future of Utilities delegates that £300bn of infrastructure spending was earmarked for up to 2020/21 and that he was "reasonably confident the new government wouldn't want to unpick the National Infrastructure Plan". He said he had particular confidence in the segment of that sum that would fall to corporate financing solutions delivered by regulated utilities, observing that "Moody's rates the regulatory environment in the UK as AAA". There are various scenarios though on how best the delivery of infrastructure should be managed. The Institute of Civil Engineers has called for the "development an independent infrastructure body which could undertake transparent and regular assessments of the viability and deliverability of infrastructure projects and report to Parliament". TWR

THE NEXT GOVERNMENT: A WAVE OF RELIEF OR FLOODS OF FEAR?

THE WATER REPORT
Accent

The Water Report in partnership with market researcher Accent is setting up an expert water group to consult every other month on a key industry issue. Group members will be emailed a survey which will take no more than five minutes to complete. Responses will be treated as confidential. Findings will be reported in aggregate only and any comments used will be anonymised.

FIRST TOPIC:
What will the new government mean for water?

We will be inviting individuals to join, but would be delighted to hear from anyone interested in taking part. Please email karma@thewaterreport.co.uk, simply with the subject line EXPERT GROUP and we will be back in touch.

GOVERNMENT PRIORITIES PAST AND FUTURE

In 2010 the Chartered Institution of Water and Environmental Management (CIWEM) published *Fitting the bill: a manifesto for environmental action.* Heading into the next general election, it has reviewed the Coalition's progress against the 24 areas it identified in 2010 as requiring urgent action over the parliamentary term. CIMEM is disappointed, saying: "There has been no meaningful progress in more than half of the areas identified, reflecting a disappointing commitment to environmental protection." Of the six areas in water identified as requiring urgent action, CIWEM is satisfied with progress in only one.

Good progress made / Progress attempted / No meaningful progress or declining status

SUDS
- Progress on delivering sustainable drainage systems has been poor. Guidance, maintenance, adoption and how they are dealt with in the planning system need resolving.

REGULATION
- The Water Act 2014 introduced a new statutory duty for resilience on the financial regulator Ofwat.

METERING
- The Water White Paper lacked ambition on metering.
- Metering of properties has improved but not driven by the Government.

EFFICIENCY
- Hot water energy efficiency is tackled by the Green Deal and ECO but more progress could be made.
- Prompted by the Government, WRAP and the industry has introduced a voluntary labelling scheme for water efficiency.

WATER STRESS
- Water companies are not statutory consultees within the planning system.
- Water neutrality is not considered in planning guidance for new developments.

FWMA
- Lead Local Flood Authorities were given funding for their roles under the Flood and Water Management Act, however not all of this was spent on flood and coastal erosion risk management.
- Funding for flood and coastal erosion risk management was cut following the election and remained low until after the winter 2013/14 floods.
- Recently the Government committed to a six year capital programme for funding flood schemes.

Looking ahead, the Society for the Environment has published a series of short papers from its various members specifying what the next government's green priorities should be. It rejects the view that the environment is way down on voters' priority lists, arguing that the state of the environment is crucial to many areas the public holds dear, including health, the economy and food security.

Because of the holistic approach taken by the Society's report, there are water implications from a number of the priorities highlighted. For instance, its call for soil protection would, if delivered, have positive implications for water quality and management. President Tony Juniper observes: "Soils sustain more than half of our food supply, purify water, combat flood risk and store vast quantities of carbon. All these benefits are being undermined through reduced soil health."

Likewise the report's call for ecosystem restoration and long term sustainable infrastructure would affect water. Juniper comments: "The Coalition government set out ambitious goals in turning back the historic tide of decline, but so far policy-makers lack the frameworks needed to realise the aim adopted in 2011 of leaving nature in a better state than any previous generation. By committing to new frameworks this aspect of policy would have far more chance of success."

Only a handful of water-specific priorities feature, chiefly:

Shale gas: CIWEM argues water management should be integrated into shale gas plans. Specifically:
- water companies should be actively engaged in the planning process for any shale gas operations to minimise the impacts associated with water supply and effluent treatment
- there should be an appropriate level of recycling of stimulation fluids, flowback and produced water onsite, to minimise the requirement for road transportation of both fresh and wastewater
- shale operators should demonstrate before they commence operations that they have identified an appropriately permitted receiver for any solid or liquid wastes which may be required to be treated off-site.

The first of these will be answered imminently: regulations under the Town and Country Planning Act that will make water companies statutory consultees for fracking were laid before Parliament in March and are due to come into force in mid-April.

Flood risk management: CIWEM, the Institute of Water and the Landscape Institute jointedly call for the next government to:
- resolve the ongoing inaction over the adoption of sustainable drainage systems and fully implement the key outstanding provisions of the Flood and Water Management Act
- develop long-term, more strategic planning for flood risk management over a period of up to 25 years to help inform decision making and the prioritisation of approaches and measures
- embark on a comprehensive programme of retrofitting property level protection for homes and other buildings at high flood risk.

The reports can be found at:
Coalition delivery – http://bit.ly/1cmechc
Next government priorities – http://www.socenv.org.uk/events/priorities-for-the-next-government/

A BIG ASK

Most companies have introduced a cross subsidised social tariff from this month, but the explicit requirement to gain customer support has been difficult and restricting. Would a more centralised approach have been better? And is it all about transferring wealth to the poorest or could we all gain in the end?

Cross subsidised social tariffs have been long in the making. After the principle was enshrined in Section 44 of the Flood and Water Management Act 2010, it took two years for DEFRA to issue guidance in June 2012, and with the exception of a few early movers, it is only this month that most companies have actually got schemes off the ground.

While cross subsides are extremely common, found in fact in most walks of life if you look hard enough, the DEFRA guidance was unusual in insisting customers endorse paying a particular amount more to fund discounts for those who struggle with their bills. It said: "The government expects an undertaker's proposals for a company social tariff to be acceptable to their customer base. This includes broad acceptance from households that will benefit from the social tariff and from those household customers that will be asked to contribute to the cost."

The guidance also handed complete discretion to each water company to consult its customer base and design a scheme based on the results. It therefore eschewed a prescriptive approach ('these are the people who should be helped; what will that cost?') in favour of a localised approach based on willingness to pay ('this is how much customers are willing to put into the pot; how will companies allocate that funding?'). A separate process was followed in Wales, where the Welsh Government issued its own guidance and offered a guideline cross subsidy level of 2.5% of the average household bill, which works out at £15-16 a year.

To complicate matters further, there is no universally accepted definition of water poverty, and DEFRA did not specify any sort of affordability threshold companies should have regard to in its guidance. In the absence of anything else, many companies have fallen back on Ofwat's suggestion that those who spend 3% or 5% of their income on water and sewerage could be considered to have affordability problems.

There has been debate over the adequacy of these arrangements since 2010 – both in terms of the absolute level of help that can be funded through an explicit cross subsidy, and in terms of postcode lottery. The Consumer Council for Water has long argued, and still does, that a tax and benefits based solution would be more appropriate.

So with the social tariff theory this month being put into practice in most parts of the country, it is a good time to look at companies' experiences and at what they have been able to put on the table for vulnerable customers. The Water Report invited all 18 companies to contribute to this piece and would like to thank the 12 companies who engaged through interview and information provision.

Customer receptiveness

Most companies took the opportunity afforded by PR14 customer consultation work to sound out views on social tariffs as well. This was typically followed by more detailed modelling to develop specific proposals, which were then put before customers to scrutinise. For many the process had multiple phases and used a number of methodologies. Companies had a broad spread of experiences.

Dwr Cymru had the standout positive experience, with customer support for a cross subsidy of up to £15 a year, to cater for anyone who meets low income-based criteria. Julia Cherrett, managing director of customer services, says the country-specific guidance from the Welsh Government was helpful here, but that the defining factor in achieving this level of support was her company's not-for-profit business model. She explains: "We used a standard methodology, and our research was carried out >

by Accent, which did a lot of companies' research. The big factor is that customers are aware we don't have shareholders, so they can't expect shareholders to pay. They know that one way or another they have to pay for it [vulnerable customer support] so see this is a fair way of doing that.

"They did expect the company to contribute too, so we are absorbing the admin cost and contributing a third on top of what customers will pay" [which is £6.47/year by the end of AMP6 – like many companies, Dwr Cymru will collect less than the maximum tolerable to customers initially, increasing it in line with growth in recipient numbers]. This far greater customer appetite to fund a hardship scheme on the back of Dwr Cymru's not-for-profit business model has interesting implications for the wider trust and legitimacy debate in the sector.

Other companies that had relatively positive experiences were Sutton & East Surrey and South West Water. Sutton and East Surrey's customer projects manager Nicola McCormack said there was "not much negativity" at all on social tariffs from its customers, and that around 70% agreed its £2 proposal was "reasonable". This is likely to be in part at least because it has an affluent customer base.

Compared to their peers in the rest of the country, customers in the South West can be considered switched on to the cost of water, because of their historic high bills. South West Water's customer policy and relations manager Sally Mills explains her company was one of three social tariff early movers, introducing its offering on 1 April 2013. Customer engagement ahead of this was a long and detailed process, Mills recalls, running to three phases and involving CC Water. "It was not just accepted on the basis of one question – we asked a raft of questions to understand people's acceptance and willingness to pay," she says, adding CC Water's involvement was central to the process. In the event, the company secured 57% acceptability for its cross subsidy proposal, and 67% said they would support it if you included those who were indifferent.

In the middle band of experience around customer engagement we find companies including Anglian, South East and Southern. Typically they managed to secure support for a relatively small cross subsidy, and customers had clear views on who should be helped. In Anglian's case, says Neil Manning, head of income and tariffs, "customers said benefit receipt was not a good indicator of the need for help and that the tariff should be based on each individual's financial situation not targeted at any specific group. We can see that's the fairest approach. If you target a group, say pensioners, there might be younger people that are in more need but don't qualify". To offer independence and impartiality to customers, Anglian is now working in conjunction with Citizens Advice Bureau, which is assessing eligibility for its social tariff.

This far greater customer appetite to fund a hardship scheme on the back of Dwr Cymru's not-for-profit business model has interesting implications for the wider trust and legitimacy debate in the sector.

Head of billing and collection at South East Water Simon Mullan reports a similar experience. "We got support up to a limited value and we found it wasn't for stereotypical groups such as those on benefits. Our customers wanted us to focus on vulnerability much more broadly."

For some companies, it was an outright struggle to gain support for any kind of cross subsidy. Northumbrian Water's customer collection manager Mark Wilkinson says despite going through two rounds of research and involving specialists including CC Water and the company Customer Challenge Group "we couldn't have had a more resounding 'no'". He puts this down to the characteristics of Northumbrian's regions, particularly its northern patch. "We have some of the poorest levels of income deprivation in the country," he explains. "The sheer volume of unemployment is enormous and incomes are low, so many of our customers can find themselves in a vulnerable financial position. It's no great surprise that asking our customers to pay more might not be widely welcomed."

He recognises though that given both sewerage providers in Northumbrian's Essex and Suffolk area managed to secure some support for a cross subsidy, that there may be something in the way the question of support is put to customers. "You design it as ethically as you can, we all do, but I suppose everybody has a slightly different wording and perspective."

Southern Water chief executive Matthew Wright agrees. "I think there is inevitably something in the way the question is asked," he says. "I'm not suggesting they [companies who were unable to secure support for a cross subsidy] asked the wrong question but I do feel that if you ask, say, do you want to pay more so this other person pays less, that's probably going to get to 'no'. If you invest the time to explain what it is you are trying to do, maybe you've got a better chance of explaining the idea behind social tariffs."

Gary Dixon, domestic retail director at United Utilities, says the company had to work really hard to gain customer support for even a very low level of cross subsidy. It operates in an extremely challenging area, where deprivation levels are 20% higher than the national average and where in parts Universal Credit has already been introduced.

Its first piece of research was open in nature, seeking customer views on the concept. "It was very difficult to get customers to support the launch of a social tariff even in principle," he recalls. "A lot felt it wasn't the water company's job to do that." It only managed to secure support through a second round of research which pinned specific options down for customers to consider. Throughout it worked closely with CC Water and an expert researcher.

Dixon says: "We got support for a bill capped at £250 but only for a very narrow band of customers – those on Pension Credit. And customers expected us to match whatever they put in. So we've agreed 47p, in total, of which customers fund half and we fund half [United Utilities also absorbs all administrative costs].

If we hadn't done that, we wouldn't have got customer support at all. We hope to extend the tariff to a wider group in time, but wouldn't do that without a mandate from customers."

On the back of their customer engagement activity, most companies have been able to offer a social tariff since 1 April. Water UK quotes the figure 14 out of 18 companies, though there is some debate on how a social tariff should be defined; specifically, whether there has to be a cross subsidy element for it to qualify. The new

COMPANIES AND THEIR CROSS-SUBSIDISED SOCIAL TARIFF OFFERINGS, AT 1 APRIL 2015 (note: information is drawn only from those who participated in research for this article, not industry-wide)

Company	Annual cross subsidy per non-eligible customer	Bill discount available to eligible customers	Eligibility criteria
Sutton & East Surrey	£2 fixed for 5yrs	50% off	Below HMRC low income threshold (c£16k) & either: 62+, registered disabled, parent of child under 5; benefits claimant
Anglian Water	£1, reconsultation expected before 2020	4 bands (20%; 40%; 60%; 80%) off, depending on customer circumstances. Meter compulsory where feasible.	Based on water as a proportion of disposable income; no restriction to specific groups
South West Water	Up to £2, in addition to range of existing affordability measures	3 bands (15%; 25%; 50%) off, deepening on customer circumstances	Based on income and expenditure assessment; no restriction to specific groups
United Utilities	23.5p (match-funded by UU so total cross subsidy is 47p). Hope to expand after year 1	Capped maximum bill of £250	Those on Pension Credit only
South East Water	50p starting point; customers accept up to £1.50	Capped maximum bill of £140	Below HMRC low income threshold & spending 3% of income or more on water
Dwr Cymru	£6.47 by end of AMP6, customers acceptability of up to £15. Company to fund cross subsidy of a third on top of customer contribution	4 bands of capped bills, ranging from £184-£379, depending on customer circumstances	Based on total household income; no restriction to specific groups
Wessex & Bristol	Customers accept up to 50p, but company expects to use less	6 bands, offering up to 89% off, depending on customer circumstances	Now based on income and expenditure assessment; was previously restricted to those on benefits
Thames Water	£1 to start, rising to £2.50 by end of AMP6 as take-up grows	50% off	Below HMRC low income threshold & spending 3% of income on water & either: 62+, registered disabled, parent of child under 5
Southern Water	£1 to start; company to undertake further willingness-to-pay research	Banded discounts ranging from 20%- 90%	Based on bill-to-income ratio of at least 5%, with income defined as total household income after deductions for tax and housing.

breed of tariffs enabled by the Flood and Water Management Act are cross subsidy specific, but from a recipient point of view, help is help wherever it comes from and however it is funded.

Early movers

On this basis, Sue Lindsay, head of customer relations at Wessex Water (who is also speaking on behalf of Bristol Water, given the two companies share billing and collection arrangements) explains Wessex has had a social tariff in place since 2007. Its low rate tariff Assist, groundbreaking at the time, remains virtually self financing. The company offers a range of help to struggling customers in partnership with specialists including Citizens Advice and Step Change. This includes low rate tariffs, debt repayment schemes, holistic money management advice and assistance beyond their water bill. This enables customers to pay something rather than nothing, which means the scheme almost pays for itself. "Assist customers on average pay around £50 a year more for their water than before they were on the tariff," Lindsay reports.

Around 17,500 customers are receiving help from Wessex/ Bristol of one sort or another, a growth of 25% over the past year. The companies plan to reach a further 15,000 customers over the AMP period. The only changes in 2013 in light of the Flood and Water Management Act provision were that eligibility for Assist was no longer open only to those on benefits but to anyone in financial difficulty; and that support was found from customers for a 50p cross subsidy. "But," says Lindsay, "because of the way Assist works [virtually self-financing], the cross subsidy continues to be negligible and well below 50p."

As noted, South West Water has offered a social tariff since 2013. "It was then that our customers benefitted from the £50 government contribution, which helped address historic unfairness, so we felt it was the right thing to offer a social tariff too, to address affordability," says Mills.

A little less experienced but still a year ahead of most of their peers are Thames Water and Sutton and East Surrey, both of whom introduced a social tariff on 1 April 2014. In Sutton and East Surrey's case, the company funded a 25% discount and aimed for around 2,000 sign ups. It had secured 2,800 by the end of March. From 1 April, it increased the discount available to eligible customers to 50% and introduced a £2 cross subsidy. It is aiming to recruit and maintain around 5000 recipients over the course of this AMP.

Thames had a different experience, of incredibly low take-up in year one, clocking up just 280 takers by December. Consequently it revised its application process and eligibility criteria from 1 January, primarily by removing a requirement to be on benefits to apply. The adjustments are showing promise, with 2,300 customers brought on by March. Thames' target is to move 37,000 customers onto the social tariff by 2020.

April shower

For most other companies, including Anglian, South East, Dwr Cymru and United Utilities, schemes went live at the start of this month. Dwr Cymru with its mandate for the largest cross subsidy in the industry has the most ambitious plans. The 60,000 customers it currently helps is expected to be boosted to 100,000 on the back of its replacement of Welsh Water Assist (broadly equivalent to WaterSure) with two schemes from 1 April. Most metered customers will be moved onto a tweaked rebrand of the old scheme, known as WaterSure Wales. Unmetered customers will for the most part be directed to the new cross subsidised Help U scheme, where bills will be capped according to household income level.

The context for all this recent activity has been political pressure exerted by the Labour party – in particular its call for a national affordability scheme and its depiction of companies as heartless profiteers. But in reality there are good practical reasons why schemes are only being introduced now. PR14 customer engagement provided an opportunity to test the water with customers and the start of a new price period is a logical time to introduce a scheme. For many, gaining acceptability has been hard and long drawn out, while all have had to grapple with the inherent complexity of defining who to help and by how much.

Northumbrian, who got unequivocally turned down by its customers on a cross subsidy, has taken matters into its own hands and come up with a cost neutral scheme to offer help in the absence of extra funding. It will be referring financially challenged customers to Stepchange for an independent income and expenditure assessment. Where customers are found to be spending more than they get in, the company will neutralise the deficit up to the value of half the customer's annual water bill, thus giving them more chance to make ends meet.

Wilkinson elaborates: "If customers get further and further behind with their bills, there is no incentive for them to pay, it becomes a big worry for them and can be demoralising. In many cases we eventually have to write off the debt, so why burden the customer with that? And if we can get customers to pay something, that is better than them paying nothing." He hopes to recruit a couple of thousand customers onto the scheme this year, many of whom will be drawn from the 15,000 who already have some kind of affordability arrangement with the company.

A handful of other companies didn't launch a cross subsidised scheme on 1 April. Some because they hit a brick wall with customers. Anglian wasn't, for instance, able to secure support in its Hartlepool Water area. Manning says CC Water advised letting customers in each area go their own way rather than spreading willing-to-pay customer subsidies from the main area into Hartlepool too.

Others such as Portsmouth Water have opted to wait. Head of retail Paul Barfoot explains: "We have the lowest charges in the country. An average bill is £97. The average sewerage bill our customers pay to Southern is £286. So alone we were unlikely to be able to help anyone very much. So to keep it simple for our customers, we are planning to mirror Southern's terms. We are working now with CC Water on research that will put Southern's proposition to our customers. We'll look to mirror Southern's eligibility criteria and so on so in time we can approve customers for the tariff on each other's behalf, as we currently do WaterSure."

This raises an interesting point: that for water only companies, harmonising tariffs with the sewerage providers active in their areas has been a particular difficulty. Mullan says South East has endeavoured to make it as simple as possible for its customers by working with Thames and Southern even though its scheme is different from either of theirs. As it bills on Thames' behalf, South East will also be able to approve social tariff applications on Thames' behalf. Southern issues its own bills, so South East can't administer its scheme but has agreed protocols to exchange information.

The tariffs

So where has all this led? The table on page 9 sets out the key elements of the cross subsidised social tariffs companies which contributed to this article are offering. In terms of the cross subsidy level itself, Dwr Cymru customers have agreed to pay the most; Sutton & East Surrey and South West customers have agreed double the amount (£2) most other customers are prepared to pay (c£1); while the customers of Wessex/Bristol (by company choice) and United Utilities (because of low support) will pay the least.

There is wide variety too in terms of the bill discounts the cross subsidies will fund, though in terms of type the industry has divided into two clear groups: those who have gone for simplicity and capped bills; and those who are offering percentage discounts. Some are going for deep, narrow discounts where fewer customers are given hefty help; while others have opted for shallow, broad discounts, spreading a smaller amount of help to a bigger number of customers.

The eligibility criteria for scheme applicants ranges at the most narrow from United Utilities' Pension Credit-only stance to companies including Anglian, South West, Dwr Cymru, Wessex/Bristol and Southern that have gone for an approach based entirely on each customer's financial situation.

In terms of how many customers each company intends to help, again there is wide variety. These numbers are not directly comparable, though, in that they reflect not only cross subsidy appetite and discount structure, but also the population size and affluence of the area. Many companies appreciate sourcing recipients will be half the battle, and are planning a plethora of internal and external activities.

Lindsay says of Wessex/Bristol's whole affordability suite: "Our focus is going to be on promotion and uptake achieved largely through a massive community engagement programme. Engaging with this group of customers is notoriously difficult. We have an affordability action plan which has so many elements – simpler and more engaging publicity materials; training for staff on how to spot more subtle signs of financial difficulty; training on mental health awareness [as this is often associated with poor money management and debt]; maximising partnerships with the debt advice sector; running community events such as pop-up shops, debtor surgeries and talks; joining a whole plethora of local networks to extend our partnerships outside of the debt advice sector; introducing online referrals on our website; ready-made materials and information for anyone who wants to partner with us such as housing associations, carers, children's centres, credit unions."

Affinity Water has been innovative in terms of recruiting recipients, recently doing a deal with housing association North Hertfordshire Homes to put around 3,000 tenants on its LIFT social tariff. Eligible residents will pay a capped water bill of £90 a year – saving £87.

Good to be different?

Although patterns across the industry are evident – most obviously perhaps the large grouping around the £1 cross subsidy level – there is a lot of diversity and this is unsurprising. Different geographical areas have different characteristics and demographics; indeed enabling locally suited solutions to be found was a key part of the rationale to give companies freedom to design something right for their customers.

Local flexibility finds significant support among our interviewees, many of whom point out that we already have a national social tariff in WaterSure, so the ability to supplement this with a locally designed second social tariff is very welcome. Dwr Cymru's Cherrett is pleased Wales has been able to go its own way. "The difference in approach in Wales has been very helpful to us," she says. "It's been framed as part of the tackling poverty agenda, and sits well with the landlord regulation that has been brought in."

Working within the DEFRA guidance framework, many English companies including South West Water, South East Water, Wessex/Bristol and Thames also welcome the local flexibility they have been afforded. Lee McGouran, affordability programme manager at Thames, sums up the sentiment that his company has "developed the best range of services possible to help our customers who are genuinely struggling to pay. This, however, is not necessarily the best solution for those in other parts of the country, outside of our region".

Perhaps more surprisingly, some of the companies who have struggled to get a cross subsidised social tariff in also support the decentralised approach. United's Dixon says: "It would be difficult in the UK to find a one size fits all solution. We need local flexibility. Our deprivation claim alone [the company received a special £19.2m allowance from Ofwat as part of its PR14 settlement to cover the higher cost of serving an exceptionally deprived customer base] shows the level of regional variation. We couldn't for example pin payment to an average salary level or anything like that, because an average salary in the North West is far lower than an average salary in the South East."

A more centralised approach would have stopped what's developed into a 'postcode lottery'. It's been done under the banner of local flexibility, but I'm not sure it's served the greater good by allowing flexibility.

However there is an alternative view: that a more centralised scheme would have been preferable. Portsmouth's Barfoot adopts this view for practical reasons: a national scheme, he says, would "touch more people", be easier to promote through national media, and be simpler for customers who have separate water and sewerage providers.

Anglian's Manning also holds the view, but for different reasons. "A more centralised approach would have stopped what's developed into a 'postcode lottery'. It's been done under the banner of local flexibility, but I'm not sure it's served the greater good by allowing flexibility. There is a plethora of schemes and different >

Old-fashioned values: United Utilities customers only agreed to fund bill help for those on Pension Credit.

levels of support depending on where you live.” He comments too that areas with higher levels of deprivation have come off worst.

Manning points out that he is not advocating a centrally funded national scheme, but one where some elements are prescribed and others left to local discretion. “For example, DEFRA could have set a minimum cross subsidy level and only if companies wanted to go beyond that would they have to consult their customers.” This, he says, would have drastically speeded up the process for many and reduced the variations between different water companies. Manning would also like to have seen affordability clearly defined so companies could more easily and more consistently target those in most need.

The idea has legs and finds favour elsewhere. Northumbrian's Wilkinson says different arrangements in different areas are both “difficult for customers to understand, particularly those who live on water company borders, and a postcode lottery – if you move a street, you may no longer be eligible”. He adds there appears to be a “north/south divide issue, where companies are finding it harder to get approval in the north”. He advocates a standard cross subsidy across the board, and then that each water company should decide how that money is spent after customer consultation. “For example, we'd have a big volume of customers needing help with smaller bills, while other companies may have a smaller volume of customers needing help with bigger bills.”

> **Interviewee after interviewee stressed that this new breed of social tariff is just one part of the affordability assistance package their company offers.**

Sutton & East Surrey's McCormack says more agreement on eligibility would have been preferable, be that based on income level, proportion of spend on water or whatever.

Best foot forward

In the round, it seems companies have done their utmost to make the best of the policy to help the poor by taking a little extra from everyone else, area by area – whether they support its underlying concepts or not. Beyond that, some seem genuinely happy to administer the scheme, seeing it as the right thing to do if it is something their customers support. For some individual customers, particularly those who qualify for the deep discounts on the table, the scheme could really help. Others question its fairness; whether water customers are best placed to take responsibility for the poorest in society; and its more practical mechanisms – particularly the requirement to obtain overt customer support for even very low levels of cross subsidy.

As a mechanism to help the poorest in society, there is a broad if not explicitly voiced consensus in the industry that social tariffs are woefully inadequate. Interviewee after interviewee stressed that this new breed of social tariff is just one part of the affordability assistance package their company offers. Collectively the industry will spend £40m in 2015-16 on affordability schemes. United Utilities' Dixon expressed the sentiment most strongly by specifying up front that the interview could not only be about the social tariff. “It's just not a silver bullet for us,” he explains. “It doesn't address all of our issues and is just one of many schemes and activities we run.” These include WaterSure, debt matching and write off arrangements, a trust fund, free meters and Water Direct – the sort of thing that will be familiar to the wider industry. United Utilities plans to help 100,000 customers in one way or another over the course of this AMP.

Self-financing?

But there is a potential silver lining for non-eligible customers in all of this. That in line with Wessex's Assist philosophy, reducing bills to more manageable levels for struggling customers should encourage them to pay something when they probably would otherwise have paid little or nothing. And that being the case, there is the potential to reduce the average £15 cross subsidy every customer already pays (without being asked) for bad debt – possibly to the extent that it neutralises the social tariff cross subsidy.

Southern's Wright makes the case: “The whole point about social tariffs is they are not just about a transfer of wealth. They're about helping people move beyond the situation where they simply close their mind to it [bill payment] because they can't cope. With our New Start scheme, let's say you have debts of £500. If you pay £10 a week over a year, we'll pay £10 as well and you halve the debt basically as long as you get into the pattern of repayment. That sounds like an aside but it isn't in context of the whole theory behind social tariffs.

“If you provide a cross subsidy to customers who are in debt, you will get better outcomes and actually greater payment from them than you would've done had you not offered it. So it's not just a zero sum game, a transfer of wealth. What we all need to get the experience of is, if we do provide that cross subsidy, is there less default on debt? Do recipients get into a better payment history? Do they sustain payment longer than they would have otherwise done? And therefore does the bad debt charge for everybody else – this famed £15 per customer – come down?

“We could actually get it to the point where it is self financing and that would be fantastic. That would be a real success and it's what we're trying to do…As a customer, if I'm already paying £15 and that can be brought down to £14 or £13, and I recycle my £1-2 pounds back in and it's positive in that it helps people out of poverty, then that is a good thing.” TWR

MEASURE OF SUCCESS

Home three: Wright (r) with Green Doctor Dan Miller (l) and a Southern customer (c).

Five years ago, Southern Water bit the bullet and became the first company to adopt a compulsory metering policy. With the rollout all but complete, chief executive Matthew Wright says demand management expectations have been smashed and the experience has given Southern an appetite to lead the way on other thorny issues.

As AMP5 came to a close at the end of last month, so did the main rollout phase of Southern Water's ground-breaking universal metering programme (UMP). The company aimed to increase meter penetration in its area from c40% to c92% in 2010-15 – the first time any UK water company had attempted a move to near universal measured charges.

Looking back at the end of the five year period, chief executive Matthew Wright says the programme has exceeded Southern's expectations on demand management, but also that the experience has taught the company about so much more than just the water consumption habits of its customers. In fact he says the UMP involved a number of pioneering elements and firsts for the industry beyond the core move to universal measured charges (see box p14). And that Southern's successful handling of, what back in 2009 looked like a really tough nut to crack, has given the company confidence to put itself forward to step up in other areas.

Wright elaborates: "Being first has given us a confidence to want to lead in certain areas, because it didn't end up being as scary or as difficult as people might have thought. We now have confidence to be in the vanguard on other things; to be in the lead on some of the thornier issues. It has given us a belief that you can tackle some of the seemingly intractable issues and do them successfully."

Least cost option

Southern secured funding to meter its entire customer base as part of its PR09 settlement, after considering a broad range of supply-side and demand-side solutions to growing demand pressures in its already seriously water stressed geographical area. "It came out on a least cost basis as the major intervention we should make in that five year period," explains Wright, pointing out immediately that he was not employed by the company at that time, so can't take personal credit for the decisions made. If least cost was to be achieved, though, it hinged on efficient delivery, and that pointed the way towards a universal rollout. "The efficient delivery was ultimately the thing that drove it to being a mandatory or, as we say, universal programme," Wright observes. Crucially, the policy had the support of 85% of the company's customers, who said measured charges were a fairer way to pay.

Five years on and around 500,000 meters later, and the UMP has smashed all expectations on demand reduction. A University of Southampton study published earlier this year, based on a sizeable sample of 250,000 customers, found metered households are using on average 60 litres a day less water. This equates to a 16.5% reduction – far more than the national average reduction when a meter is installed, of 10%. Now it is nearing the end of the programme, some 30 million litres of water are being saved every day across Kent, Sussex and Hampshire. Southern's meters also include leak alarms, and so far over 6,600 leaks have been detected.

"Pleasant surprise"

Wright says the Southampton numbers were "a pleasant surprise" and adds: "The really interesting thing from an investment perspective, bearing in mind the whole purpose was to avoid incremental investment in resources, is we've seen that when it's warm – and we had something of a summer last year – we actually saw a bigger reduction in peak demand than we did in average demand. That is really important because you build for the peak."

Of additional interest is the fact that reduction is not a one-off; according to the research there is a general trend of continuing reduced consumption over the period of the first five bills (two and a half years) after switching to metered charges. Perhaps even more surprisingly, the study found households start changing their behaviour as soon as the meter is installed, despite the fact that for three months they have no financial incentive to do so because metered charges are not applied in this grace period.

We can only assume this reflects the effectiveness of Southern's communication programme, both in raising awareness of impending meter installation (via a range of measures including leafleting, signposting, mobile units and staff on the ground) and of how customers can cut their water use. Wright elaborates: "Before a customer switches over, we give them an indicative bill for three months based on metered charges. In reality they are still on unmeasured charges, but we read the meter and say you are about to switch over to measured charges and your indicative bill for this quarter would've been this. That's x per cent above or y per cent below what you currently pay and here are some things you can do about it."

Affordability

The big worry was of course affordability; more specifically, how the least able to deal with being adversely affected by having a meter installed would cope. Following extensive customer and stakeholder consultation, the company put three tariff options in place, supported by additional measures for the vulnerable. The tariffs, which remain in place today, are:

- Standard metered charge
- Changeover tariff. This is phased in over three years, with the customer paying 1/3 metered charges in year one; two-thirds in year two; and the full standard metered charge in year three. Customers have to proactively opt onto this tariff, after customer consultation said it should not be the default option. Southern has however enthusiastically pointed people to the Changeover option, particularly those with difficult payment histories or those who would lose out significantly from the switch to a measured bill.
- Support tariff. Here the bill is pegged to what it would have been had the customer remained on rateable value charges. Southern sources customers for this assistance tariff in a variety of ways, using both its own records and insight and those of partners such as Citizens Advice. As a condition of receiving this subsidy, Support tariff customers are visited by a Green Doctor who will perform a Home Saver Check free of charge. This is a water audit and the fitting of efficiency devices. On average, Green Doctor actions result in savings of 20 litres a household a day. Green Doctors are also able to arrange for customers in hardship to receive advice from IncomeMAX – an independent organisation which advises customers what benefits they are entitled to. Since 2010, IncomeMAX has helped customers secure more than £3 million in benefits.

Original plans for a seasonal tariff were dropped when they met hostility from customers.

Winners and losers

In aggregate, 62% of Southern's customers who have gone onto a meter are winners, saving an average £162 a year on their combined bill. The remaining 38% have lost out. Wright points out that this loser group contains a number of different types of customer: those who simply accept that their circumstances mean they should pay more – for instance the better off with large houses and gardens; those who object in principle to paying more but can afford to; "and most importantly there are people who struggle to pay their bills and maybe were already struggling and this compounds it. We recognise that and have a safety net to protect them". This safety net consists not only of the Support tariff, but also the company's broader range of vulnerable assistance schemes and its new social tariff (see feature, p6-10).

Even factoring the losers in, Wright is adamant that the UMP was the right choice for its customers: "It's easy for the losers to say this is all about charging more, more profits for utilities and so on. The reality is it has saved customers money overall because it's the least cost solution. So net net, it's cheaper. And it's all based upon what 85% of people think is a fairer way to pay, so it's the right thing to do. There are losers and that of course creates some issues. So we've tried really, really hard to smooth the impact for people when there is a significant impact."

Impact on complaints

He also offers up for scrutiny the company's complaints record on meter-related issues. "We've had complaints, of course we've had complaints. Some people complain on philosophical grounds as much as anything. But there have been comparatively few complaints considering what we were doing. That is a qualified statement because, being first, we didn't have a good comparator, but certainly the estimates we had for complaints arising directly out of the metering programme have not been realised."

Wright makes further comments on complaint levels that will interest companies such as Thames Water in particular as it embarks on a universal meter rollout programme of its own, and the rest of the industry more generally as the proportion of customers on meters nudges up incrementally. "Measured customers are more complicated from a service perspective than unmeasured customers; they contact you more and have more cause for complaint. Why? Because if you had a rateable value bill, there's no basis for dispute or argument really. You wouldn't even know if you had a leak. If you do have a meter, that leak would show up on a measured bill as high consumption. So the knock-on effects of having a predominantly measured customer base is it is actually more complex to serve than having a predominantly unmeasured customer base.

"People may say that sounds like a bit of an excuse because we are not troubling the top of the league table in terms of things like SIM scores and complaints numbers. In fact our performance is relatively poor and needs to improve and I am not making an excuse for that – it is a massive focus for the management team. But it is a fact and it is recognised in the way Ofwat remunerates through the retail price control i.e. that measured customers cost more because of the greater contact and interaction. That is something we probably underestimated."

AHEAD OF ITS TIME: PIONEERING ASPECTS OF THE UMP

A totex solution before totex was mandated. Wright says: "I think (the UMP) was quite bold because certainly at that time, the default would've been to build stuff – not least because at that time we still had a model that incentivised putting things into the RCV. While there is a capital expenditure associated with meters, it's not quite the same as traditional solutions, which would've been to build a reservoir or whatever. It was untraditional in that it tackled the demand-side rather than the traditional supply-side."

Efficient delivery of metering. Mandating metering was, says Wright, "a real sea change in the way demand-side metering was being delivered. I think the team at the time were quite visionary in the way they conceived that." He explains the universal rollout approach was driven by a need to deliver metering efficiently. "Metering programmes done before were by definition inefficient because they had relied on either change of tenancy or voluntary changing. In order for it to become least cost, you had to conceive a different way. All credit to the folks who were here at the time for saying we're going to tackle this in the most efficient way. And that was a very different way to what has gone before. It was incredibly brave."

Extensive customer engagement pre-PR14. By the time the recent price review required companies to engage extensively with their customers and design business plans on the basis of customer priorities, Southern had already done so around metering; both consulting with customers on preferences and designing the UMP on the back of their feedback. Wright comments: "That was a first; it was the real start for Southern Water and I think for the industry to listen to what customers said and to drive results based upon that." He adds that the experience also gave Southern useful insight on more practical issues: "We learned lessons for engagement at PR14. We had an idea of what worked in terms of engagement style and the different types of research that could be used. It was really useful to draw on that experience and in fact the metering team went on to guide our PR14 work."

Customer focus not engineering focus. Despite the huge logistical and physical work involved in providing nearly every customer with a meter, the UMP was run as a customer project not an engineering project. It was sensitive to the fact that workers were in very close proximity – in some cases working inside – people's homes. "That's a very, very different proposition to, for example, working in a treatment works or even digging up the street. If you dig a hole outside somebody's house and then go and patch it with a different colour tarmac, you would be surprised how much that incenses people. So we've tried not to do that sort of thing."

Wright adds that the very selection of contract partners took this into account. "We picked the partners on the basis of economics obviously, but also on how they fitted in with this paradigm shift in terms of 'this is not an engineering project, it's a customer project' and not only that but a potentially intrusive and potentially controversial project that needed people who were sensitive to that. There was a lot of training. The guys that were digging holes were much more conscious that they were digging holes in someone's driveway as opposed to just in the street where there is no accountability to individual customers."

Partnering for legitimacy. There was, says Wright, a honest and practical acknowledgement on Southern's part that in customer eyes, it "wasn't the most credible organisation in the world". Consequently there was a policy of working with partners that customers would trust more. These included: WWF on the environmental and sustainability side; The Design Council to design customer communications and bills; on the affordability side, Green Doctors (free water audits and efficiency products) and IncomeMAX (money advice and benefits entitlement checks); and community delivery specialist Groundwork. Wright observes: "It's interesting that now company business plans for AMP6 are all about partnerships and delivery legitimacy. Here we have a project from AMP5 that was doing all of that, and again it has really, really conditioned the way we think about delivery in AMP6."

Social tariff. Wright says Southern's Support tariff (see main article) contained an element of cross subsidy (permitted under the auspices of the overall metering programme) and so was "actually the first (cross subsidised) social tariff in the industry".

Internal issues

Did Southern underestimate any other factors? Where have difficulties emerged? Wright singles out gaining access to homes where a meter has to be fitted inside rather than outside the property. "We underestimated the complexity associated with gaining access for internal installations," he admits, "either simply to catch people at home or, for the folks who are not minded to have a meter installed, it is quite difficult. We have improved our installation rates as we've gone through, but we are later than planned in completing the project because of that principally. There are lessons that can be learned from that for the companies that follow."

Southern is consequently a little shy of its 92% penetration target by 31 March 2015. In fact, Wright says it is unlikely ever to reach 92% as more properties than it estimated have proved unmeterable. He smiles: "By unmeterable, I mean economically. There's always things you could theoretically do, like knocking peoples kitchens about, but that would be somewhat extreme just to put a meter in! The 8% will probably be a little bit larger. I can't tell you exactly what yet because the programme hasn't finished, but it's likely to be around 10%."

In terms of cost, the company was allowed £97m in AMP5. The actual cost will be more than that but again because the programme hasn't ended yet the final number is currently unavailable.

AMP6 and beyond

Southern will not be resting on its laurels in AMP6, but instead will push on with its demand management activity. It secured a PR14 outcome delivery incentive (ODI) for a per capita consumption reduction by 2020, and has a package of activities in mind to achieve it. These include completing its UMP work, more domestic audits and retrofits, and education programmes aimed at range of customer types including schools, small businesses and local councils. Wright says of the ODI: "It's not about the company qualifying for an incentive; it's about reducing water stress in the South East and therefore not having to build more sources such as, in extremis, things like desalination plants which are expensive."

Its AMP6 work will stretch to further research on tariffs, Wright confirms. "We did a piece of research around the social tariff and looking at additional tariff options so it would be a natural part of our development around that dialogue. Some of our stakeholders are very keen that we explore this, such as the Green Alliance.

"I am happy to explore it. I think it's a legitimate lever that could be pulled… Our meters could for instance do seasonal tariffs or tariffs for when we had droughts. But just because we can, it doesn't mean we should. For me, whether we should will depend very largely on whether customers think it's a good idea or not. If a majority of our customers said they didn't agree with seasonal tariffs, I wouldn't be minded to go with that."

Nevertheless, he is a firm believer that having a predominantly measured customer base in itself opens up opportunities to discuss more things in greater depth with customers. "I've heard people argue that water efficiency can be done really effectively without the need for a meter. So that education in general will work and people will save water. There has to be some truth in it, if you make people aware of water stress and so on. But if it makes no difference to the amount that they pay, human nature being what it is it has to be the case that they pay a little bit more attention if they have some skin in the game, so to speak. So it has to follow that where you have a predominantly measured customer base, you are better able to drive in water efficiency messages and deal with water stress.

"It gives you a means to have a dialogue with customers to get them better educated, so even if they don't think a particular tariff is the right thing to do today, it doesn't mean they will think the same in the future if they understand the principles of water stress, costs and so on. So it has opened the door to a richer dialogue with our customers – in this case about resilience, sustainability and how we serve future generations at least cost. I think that's a really powerful thing." TWR

NEWS IN BRIEF

Sonia Phippard: DEFRA's director of water Sonia Phippard has become director of policy delivery. Sarah Hendry is acting as Phippard's interim replacement in the water role, with a selection process to follow. Deputy water director Gabrielle Edwards might be a likely permanent successor.

CC Water changes: Alan Lovell, previously chief executive of six companies including Costain, replaced Dame Yve Buckland as chair on 1 April; two new regional chairs have been appointed to the CC Water board – David Heath in the Western region and Robert Light in the Northern region; 19 new local consumer advocates have also joined the consumer representative.

Salmon for South East: former United Utilities non-executive director Nick Salmon has replaced retiring Gordon Maxwell as chair of South East Water.

Mercer on the move: Lady Susan Rice will replace Ronnie Mercer as chair of Scottish Water from 1 June. The appointment is for four years. Lady Rice is chair of the Scottish Fiscal Commission and is a non-executive director of Sainsbury's. She was a member of the First Minister's Council of Economic Advisors.

An inspector call: DEFRA has advertised for a new chief drinking water inspector to succeed Jeni Colbourne.

NIW non-execs: Northern Ireland's Department for Regional Development is recruiting five new non-executive board members for Northern Ireland Water. The appointments will start on 1 August and run for four years.

Ofwat sets PR14 true-up rules

Companies and investors have until 7 May to let Ofwat know what they think of its proposals for reconciling past performance and incentive mechanisms at PR19.

The regulator last month issued a consultation on its "PR14 reconciliation rulebook", the objective of which is to explain how PR19 will take account of performance over 2015-20.

The mechanisms that the rulebook covers could have a material impact on company revenues and RCV. Agency partners analyst Lakis Athansiou flagged as the major item resulting from the rules that what he called a "RPI bonus" element Ofwat added when it adjusted regulatory asset value at the end of March would be removed after 2020. He added: "Ofwat is saying that it will allow companies to keep depreciation and return earned on this over the 2015-2020 period, which ameliorates the reduction by 40% in value terms. This is so illogical, that we believe there will be pressure for Ofwat to backtrack on this and remove this amelioration."

The mechanisms governed by the rulebook are: outcome delivery incentives; wholesale totex sharing; the wholesale revenue forecasting incentive mechanism; household retail (adjustment of total revenue allowance for actual customer numbers); and blind year adjustments from PR09 (see table, opposite).

Specifically, the rule book sets out how the regulator proposes to resolve an issue dating from PR09 on the way it adjusted for inflation within the Capex Incentive Scheme mechanism. It shelved making a decision on this when PR14 final determinations were set (after Severn Trent Water raised a query) to avoid creating regulatory uncertainty late on in the review.

The rulebook proposes using a different approach to the indexation arrangements used in the CIS mechanism at final determinations, on the back of which Ofwat is minded to adjust all companies' RCV in PR19 (to remove the amount remaining in the RCV from the use of different indexation assumptions). It argued this would be in the customer interest and would not affect financeability in the current period as it would not apply retrospectively.

It said: "In total we consider that the potential midnight adjustment to the RCV is around 2% of the RCV, which would take place from 2020. This adjustment is likely to be outweighed by other adjustments to revenue and RCV from the PR14 reconciliation mechanisms, for example totex cost sharing."

A final decision on PR14 reconciliation is due in mid July.

Bristol case sends shot across bows

Ofwat has sent a clear message to the industry that it will take a tough line on competition infringement issues through its actions on connections complaints at Bristol Water.

The regulator chose to use its Competition Act 1998 (CA98) powers rather than its narrower Water Industry Act 1991 powers to investigate two separate complaints into the price and non-price terms Bristol applied when providing services to self-lay organisations (SLOs). The complainants alleged the company had used its dominant position to harm competition in the contestable market of providing new water connections, making it difficult for SLOs to operate in the area.

Late last month, the regulator accepted commitments from Bristol to make changes to both its structure and processes in response to the specific competition concerns identified by Ofwat. This includes a clearer separation of Bristol's downstream developer services functions, which operate in a contestable market, from its non-contestable upstream services.The commitments will now be binding and enforceable under the CA98.

Ofwat flagged that the case is of "strategic significance for the sector" dealing as it does with level playing field and competition compliance issues – issues that will become increasingly important as the water market is reformed. Richard Khaldi, senior director, customers and casework, said Ofwat's decision "raises big issues for the whole sector. All companies need to understand who the customers of each of their services are, and to make sure they are meeting their obligations to ensure a fair, effective market. This can be a particular issue when a company is delivering both contestable and non-contestable services alongside each other. It will also become even more relevant as competition increases as a result of the Water Act 2014."

Moody's said the decision was credit neutral, but that: "The binding nature of Bristol Water's commitments under the CA98 and the potential for a non-compliance penalty of up to 10% of Bristol Water group's turnover mean that the result may prove a greater deterrent to other appointees."

No decision was reached on whether or not Bristol Water actually infringed the CA98.

The connections market has been subject to competition since 2003, which means SLOs can compete for work – for instance to connect new housing developments to the network – with incumbent water companies. However, they remain dependent on the incumbent to conduct specific non-contestable services.

Summary of proposed approach in key areas

Issue	Proposed approach
Outcome delivery incentives	
Indexation	Use actual average year RPI to inflate PR14 values to PR19
Time value of money	Do not adjust for time value of money
Taxation	Allow taxation on ODI rewards and penalties as part of PR19 review
Aggregate cap and collar	Do not adjust ODI rewards and penalties for taxation comparison with cap
Scheme ODIs	We set out principles that will apply to the assessment of major scheme ODIs in PR19
Asset health ODIs	Require companies to publish further details for asset health measures where these are not included in PR14 final determinations
Wholesale – totex	
Definition of totex for menu sharing	Exclude items not included in the menu baseline such as third party costs, pension deficit recovery and transition costs
Indexation	Deflate future year total expenditure using actual RPI for comparison for PR14 allowance
Allocation of totex out and under performance to revenue and RCV	Allocate out- and underperformance using weighted average PR14 PAYG rate, with companies providing robust evidence for changes that are in customers' interests
Time value of money	Adjust for time of money for customer sharing of out-/underperformance
Taxation	Include a taxation adjustment for RCV changes only
Wholesale – WRFIM	
In period ODIs	Exclude revenue changes from in-period ODIs from WRFIM reconciliation
Taxation	Do not include taxation adjustment in PR19
Blind year	Include blind year adjustment in PR19
Water trading incentives	
Export incentive	Payment at PR19 of 50% of the full discounted economic profit for the forecast life of the export capped at 100% of the economic profit for the years the export operates in 2015-20
PR09 reconciliation	
Indexation in the CIS RCV	Adjust PR19 opening RCV for amount remaining in the RCV due to the use of different indexation assumptions. This would result in a reduction in the overall industry RCV from 2020.
COPI	Adjust for COPI when accurate data becomes available (for example, in 2016)
Blind year	Include a materiality threshold for the blind year adjustment.
Household retail	
Reconciliation	Include a wash-up between allowed and outturn revenues in PR19
Time value of money	Do not adjust for time value of money
Taxation	Do not adjust for taxation

UWWTD and WFD woes

Brussels has said it will refer the UK to the European Court of Justice because 17 urban areas have failed to meet the quality standards demanded by the Urban Wastewater Treatment Directive. Treatment in the areas is either of an inadequate standard or absent.

Meanwhile Water UK has reported emerging tensions in Europe about the future of Water Framework Directive targets. At a recent meeting, the trade body said the debate "at times became polarised between groups continuing to push for faster environmental performance and others, such as water and sewerage providers, concerned about where the money will come from".

Water UK said there was also debate about the WFD's "one out all out" rule (that a water body has to achieve all measures to achieve good status) not driving best practice because improving water quality is not reflected in statistics.

Ofwat nudges budget up

Ofwat has secured Treasury agreement for a slightly higher 2015/16 budget than initially proposed, largely on the back of the extensive market reform programme it has to deliver.

Its licence fee for the year is £21.2m, up from the £20m proposed in January. It has also been allowed to collect £2m rather than the proposed £1.5m for its Tideway Tunnel work.

The regulator confirmed its budget in its final 2015/16 forward programme, published in March.

Meanwhile the Consumer Council for Water's forward plan for the year confirmed it will focus on:

- targeting poorer performing companies and working towards an industry performance monitoring framework
- helping those struggling to pay access appropriate financial assistance packages
- influencing market reform to ensure that high standards of services are delivered and customers are protected.

RETAIL MARKET DEVELOPMENT FINALLY GATHERS PACE

Moves to deliver the non-household retail market have picked up pace, with activity in two crucial areas over the last few weeks.

Ofwat has issued a tender for a delivery partner and is looking to move as swiftly as public sector procurement rules allow in making an appointment, likely in June or July. This was the role WICS was previously expected to perform.

And industry-led Market Operator Services Limited (MOSL) is pressing on with its tender to procure central systems, including updating its articles of association to enable the process to go ahead. According to one source, the Market Operator platform deal is expected to prove competitive, with a number of large IT players interested, some in partnership with smaller specialist players who are excluded from pitching alone because of a turnover threshold qualification.

There is now no scope for dalliance if the market is to be opened on time. Speaking at the Future of Utilities conference last month, Anglian Water's regulation director Jean Spencer said a delay to central systems procurement would pose the biggest risk of all to the retail reform programme. "We are already at the edge," she said. "It would have been good to have done that [procured central systems] six to 12 months ago."

She stressed that it was in companies' interests to deliver an effective market on time "to keep our credibility with customers". Anglian, she said, had really stepped up, providing both financial and human resources to the Open Water programme; funding a data pilot; spending 70 days at workshops; and crucially becoming a founder member of MOSL alongside United Utilities and Northumbrian Water when Open Water Markets Limited (OWML) faltered following its public sector classification.

At the end of May, OWML's work will be split between Ofwat and its new delivery partner, and MOSL. Chinese walls are understood to be in operation already. TWR

NOTHING TO SEE HERE

Spencer posed a question to fellow Future of Utilities speaker, water minister Dan Rogerson: given the mixed success of energy retail, what could water learn from that market? The sentiment behind the question, she later explained, referred to security of supply threats in energy and the desirability for long term planning to continue in water in the context of reform.

Rogerson's response was surprising, implying the lessons available were limited. He said we should "be careful about reading across" the two markets, but should ensure water customers had a strong voice as developments unfolded.

Given the opportunity to comment during questions, Scottish Water chief executive and competition veteran Douglas Millican said: "We absolutely can learn from other companies, and should not only look within the utility sector but also beyond it."

MOGFORD: 'SO' ROLE FOR WATER FIRMS

Water companies operating in a reformed upstream market may need to pick up the role of System Operator, United Utilities chief executive Steve Mogford flagged up at the Future of Utilities conference.

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

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

Mogford also set out his vision of how upstream reform might play out, offering United Utilities' view of the areas of the value chain most immediately suited to contestability: water resources, sludge treatment and sludge disposal, on top of non-household retail.

He embraced the reform agenda, commenting that he could see "scope for a significant amount of of contestability" in wholesale markets. He added: "PR14 paved the way for restructuring. We've now embarked on a path which is likely to lead to some disaggregation, and a wide variety of companies providing services at different points of the value chain."

Depending on the experience of non-household retail, Mogford mulled that "competition might eventually be extended to domestic customers too". TWR

INDUSTRY COMMENT

PIC'N'MIX BEST FOR DELIVERY OF MARKET OPERATING PLATFORM

Graham Hainsworth is CGI UK's water sector practice lead. CGI has implemented 11 market operating platforms worldwide and was involved in building and running the systems for CMA Scotland. It built and continues to operate the systems that underpin one of the most consistently competitive electricity markets in the world for Elexon, in the British market.

The opening of the water market in England to competition in April 2017 will provide non-household customers with the opportunity to choose their supplier.

The Market Operator has a crucial role in ensuring that the benefits of water competition are realised. It acts as the heart of the competitive water market, enabling the flow of vital information between wholesalers and retailers and undertaking the settlement calculations that enable the trading parties to invoice each other correctly.

This is a large and challenging undertaking and one that must be implemented in just a few months.

There can never be a completely "off-the-shelf" solution for such market systems, because market rules differ in every case. But their development can be simplified by building on the experience gained in creating equivalent systems for the Scottish water market, and for the energy markets in the UK and elsewhere. It is likely that components of existing systems can be reused to accelerate the deployment and to reduce the development risk. In addition, understanding how these markets have evolved will provide insight into the challenges that will be faced by the Market Operator for our new competitive water market.

A short timeframe is far from the only challenge associated with successfully delivering this kind of multi-stakeholder programme. The market participants will also have to complete successfully their system development and business change programmes to operate as retailers or wholesalers. They will have to establish new interfaces with the Market Operator and go through market testing to prove that the industry processes work, end-to-end; all of which will require tight co-ordination. And, perhaps most critically of all, the market participants, as owners of the industry data, will have to make sure that their data is accurate for loading into the Market Operator's systems.

In an ideal world, the market codes that define how companies operating in this competitive market will interact would be fully developed and stabilised to provide a baseline prior to the design and build of both the participants' and the market systems. In the real world this will not be the case – there will be ongoing change to manage in parallel with the creation of the systems – and so organisations will need to recognise the importance of collaborative behaviours to successful programme delivery. The programme will need to have a mechanism for rapid decision making to avoid the introduction of costly delays, and robust management of the change process will be essential to keep the programme on track against a tight delivery timescale.

Of course, once this new, competitive market is established, it will continue to develop and evolve, whether through future market reforms or driven by innovation in the provision of services to consumers. The management of changes to the market codes and industry processes will be vital, as we have seen in the 25 years since the introduction in 1990 of competition to the first tranche of Britain's gas and electricity market. Some of these changes will require alterations to the market participants' or the market operator's systems, and so the solution design should incorporate this and recognise the value of flexibility and adaptability to the long term operating costs of the market.

Whilst much can be learned from the competitive water market in Scotland, in that case multiple retailers are only interacting with a single wholesaler. Perhaps the best market to look at to inform the approach is the opening of competition for non-household energy consumers across all three tranches in 1990, 1994 and 1998 – where multiple energy retailers interact with multiple wholesalers.

Realistically there are three options for the delivery of the Core Market Operating Platform:

- *1. Re-use existing solutions, whether from the Scottish water market or the competitive energy market.*
- *2. Develop new systems.*
- *3. Employ best of breed off-the-shelf products.*

In practice, the chosen approach may combine some or all of these.

Re-using the Scottish market systems deployed at CMA Scotland is certainly possible. However, given the much larger scale and the shift from a single wholesaler model to one where there are many wholesalers, the platform will require significant development. Similarly, the solutions supporting the energy market, such as those used by Elexon, will require adaptation to support the water market. In both cases the stakeholders who have invested in the creation of those platforms may also seek a commercial return for any reuse.

Building afresh offers the opportunity for the most flexible approach, and the one most tightly aligned to the market requirements. However, given the tight timescales, this could be extremely challenging and such custom developments can have longer-term total cost of ownership implications.

Combining best of breed products may allow a more rapid deployment, although it may also introduce a tension between market requirements and product capabilities. Difficult decisions may have to be made about whether to change the requirement to fit the product, or to engage in time-consuming and expensive product customisation.

Ultimately the most pragmatic option would seem to be the one which combines the strengths of each approach. Using off-the-shelf components where they support the market requirements, drawing on the relevant experience from the Scottish water market and the from the British energy market, and employing a minimal amount of new development to accommodate the specific needs of the market where no suitable product exists will offer the best chance of success.

Ultimately, it is about delivering a Core Market Operating Platform that is robust, secure, flexible and cost-effective – and that is ready in time to meet the timescales for market opening.

To make it happen, the Market Operator and their delivery partners will need people on board with demonstrable experience of doing this kind of project in a large and complex multi-stakeholder environment. TWR

MIXED EVIDENCE FOR MIXED USE

Companies are expected to source a range of evidence to include or exclude mixed use premises from the retail market. It looks difficult and messy.

Mixed use premises look set to be thorn in the side of arrangements to establish exactly which customers will be eligible to switch supplier after 2017. Where a simple test is unable to easily determine whether a mixed property should be classified as a household or a non-household, evidence of various sorts could be called into play. This could be messy, difficult and prone to dispute.

Ofwat last month issued a consultation on how best it should update its guidance on eligibility in light of retail reform. This was last updated in 2011 when the 50Ml/y switching threshold was reduced to 5Ml/y. Helpfully the regulator included information on its thoughts around how to classify premises as either households or non-households, even though not explicitly required to do so. It hoped this would go some way to "prevent unnecessary references to Ofwat for a determination… Such references are costly to parties, they may involve significant delays, and reliance on determinations creates significant legal uncertainty for the market in general."

It noted also that clear guidance on the issue was important because eligibility decisions would be important for a number of works areas, including PR14's separate price controls; SIM measures (business customers are now excluded); market code development; retail exit; and data preparation.

Ofwat has proposed that in most cases where it is not immediately obvious whether a property is a domestic or commercial building, its payment of council tax and/or business rates should be the default assessment criterion, as show in the diagram. This largely mirrors Scottish practice, which relies on council tax registers. If a premises pays both or neither, the regulator suggests recourse to Valuation Office data, which should chime with customers' self-perception and is publicly accessible. So far so good.

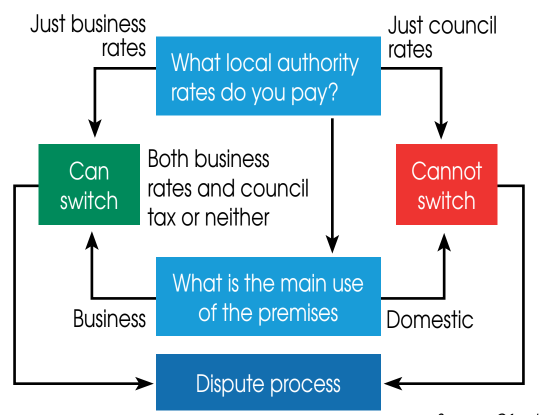
But mixed use premises such as farms/farmhouses, nursing homes and on-site staff accommodation throw a bit of a spanner in the works. In these instances, Ofwat suggests initially a simple test: the premises should be classified as non-household if the household part of the premises is dependent in some way on the non-household part. The fun really begins in situations where this test can't be applied.

In such cases, the regulator advises that companies should allocate the mixed use premises to the non-household category and then use a number of techniques to establish whether it should stay there. These include scrutiny of company data; desk based research; requesting information from the customer; and gathering evidence on-site while, for instance, taking a meter reading.

According to the consultation: "Throughout, there are a number of different types of evidence that can be taken into account in order to establish principal use. While companies are entitled to place some reliance on the assessment made by the Valuation Office even for mixed-use premises, it may not be sufficient to follow this categorisation because it is made under a different statutory framework, and for a different purpose. Particularly when the customer disputes the categorisation of a given set of premises as household premises, a reasonable company will gather additional evidence about the use of the premises."

Clearly there is no easy way of sorting mixed use premises one way or the other. But if the market has to rely on a mix 'n' match of evidence types, it could be resource intensive, time consuming and lead to inconsistency. It will fall to Ofwat to determine disputes should they emerge, but even then the regulator says "it is likely that the principal use of the premises will have to be established without relying solely on any one factor". TWR

FLOW CHART OF CUSTOMER ELIGIBILITY FOR SWITCHING



Source: Ofwat

LARGE USER QUESTIONS AND EXPECTATIONS OF RETAIL MARKET

Retail margins, data quality and deal prospects dominated large water user discussions last month at Major Energy Users' Council roadshows in Bolton, Coventry and London.

Among the issues customers raised from the floor were:

- Will a c6% retail margin be enough to encourage new entry and enable customer discounts? Could wholesale cost allocations be slimmed down?
- Will the playing field be level?
- Who will own meters and be responsible for meter maintenance if a customer switches?
- Will market data be good enough?
- What can customers do now to prepare?

There was an electronic voting session, which revealed:

- 85% of members were aware of market opening in 2017. 17% had collected data and were exploring with potential suppliers; 34% were in the process of collecting data; 34% hadn't started preparing.
- 24% expected the most benefit from competition to come from cheaper volumetric charges; 45% from water saving; 20% from easier account management; the rest were unsure.
- 40% said the main barrier to an effective competitive market was a structure which over-favoured incumbent suppliers.
- 65% expected the market to open on time in April 2017, but that it would be slow to get going.

OPEN FOR BUSINESS?

Tight margins, lack of wholesale commonality and a playing field that is not overtly level. These are not the traits of a retail market that welcomes new entrants, says Business Stream chief executive Johanna Dow.

There are obvious benefits to being the incumbent retailer in a newly competitive market as, no doubt, new entrants in the Scottish water market would testify. When that market opened back in 2008, Business Stream started out with established customer relationships and a 100% market share. It took a long while before that starting position altered in any significant way.

But the position also came with drawbacks – unique licence conditions and the like, designed to compensate for the incumbent's head start. Business Stream's founding finance director and chief executive since October 2014, Johanna Dow, jokes that she is looking forward to English water companies occupying a similar space soon. "Having been the incumbent retailer for seven years and having lived with the restrictions that go with that, it's quite nice to think somebody else will be in that position," she wryly observes.

Business Stream has long looked forward to the opening of the English market, has engaged enthusiastically in developments to date and has made no secret of its ambitious plans for growth south of the border. It has expected and planned for a rebalancing of the scales when England opens its doors to retail competition, given this will provide it with an opportunity to acquire out-of-area customers rather than just stand to lose customers from its home patch.

But as we edge nearer to 2017 and as details of the market gradually emerge, Dow says she grows concerned that arrangements are not shaping up as Business Stream had envisaged and that its position in Scotland and the position of incumbent retailers in England won't in fact be like for like. The company has three major concerns.

Retail margins

Top of the list is the major disparity between the average gross retail margin (the difference between wholesale cost and default retail tariff) in Scotland, which currently stands at 26%, and the gross average margin on the table in England, which stands at 6.5% (2.5% net). According to Dow, a c6% margin is simply too low and could jeopardise the viability of the market – both in terms of encouraging new entry and delivering for customers. She says: "We don't believe 6% is enough to cover the cost to serve customers and to allow for discounts and for new entrants to invest in innovation and new services. For me the whole point of opening the market is to benefit customers. My worry is there is an expectation from customers that they will be able to enjoy the same level of benefits as they enjoyed in Scotland and I don't believe with 6% margins we can deliver those benefits."

The Scottish experience is instructive. Market activity has only picked up from its sluggish start in the last year or so on the back of two developments: the prospect of the English market opening and bigger retail margins. The latter increased from c10% initially to the current mid 20% level on the back of declining wholesale prices. Moreover, price discounts have been influential in driving switches, particularly among the small and medium sized customers. According to the Consumer Council for Water's Testing the waters research last year, SMEs require cost savings of nearly 20% to motivate them to switch – a level that is looking unobtainable.

Dow continues: "The concern for me is the industry as a whole could invest a lot of money creating the market and having that ready to open in 2017, and then we find there is very little switching because customers cannot get the benefits they were expecting. I accept that the ultimate measure of success is not only how many customers switch, but I do think customers have a number of expectations: that they'll get access to better choice, better prices, and more innovative services, and my concern just now is that I don't think they'll get all of those with the margins as they are."

So why is there such disparity on margin levels between the two markets? Companies in England have allocated costs to their wholesale and their retail (non household and household) businesses and wholesale costs have come out heavy. Some might accuse the industry of wholesale loading to keep retail margins (and hence new entrant prospects) down, but Dow is charitable in her reading of the situation: "When you're doing it for the first time, it's really difficult to look at the costs of a vertically integrated company and decide which costs you should allocate to the wholesale elements and which to retail," she says, remarking that Scottish Water had to undergo the same process ahead of 2008.

She adds: "The additional complexity in England is that, in Scotland the company had to separate which in many ways made the process a bit easier. So for example, if you look at the costs of a contact centre which serves both households and non-households, that had to be completely separated. Unfortunately the situation in England is that separation is not going to be a requirement, so inevitably companies will look at the total cost of the service provision and have to apply an element of judgment in how each element of those costs are allocated"

She takes more issue with what she perceives as Ofwat's lack of prescription on cost allocation. "In Scotland we had clear regulatory direction on the cost allocation process, so what happened was Scottish Water initially did that allocation but it was chal-

lenged by the regulator in several key areas. As a consequence the margins were around 10-11% when the market first opened, and it has grown over the years as new activities have been allocated to retail.

"In England the companies have been set high level parameters but they haven't been given prescriptive guidance on how to allocate costs and I don't believe there has been much real challenge around how they have allocated those costs and in particular the consistency between companies."

Ofwat is thought to have drawn on comparative analysis of margins in energy in settling its position. Business Stream has pointed out that such a mature market is not directly comparable with a newly competitive one, and that water bills are way lower on average resulting in a lower absolute margin.

Things being as they are though, Dow would like to see Ofwat extend its plan to revisit the non household retail price control in 2016 to also include the wholesale control, with a view to revisiting the cost allocations between retail and wholesale. She explains: "There's two ways to resolve the margin issue. One of them is to increase retail prices. Nobody is advocating that because at the end of the day the customer shouldn't be disadvantaged. The other way is to look at how costs are allocated between retail and wholesale. We would like Ofwat to reopen both price determinations – retail and wholesale – to revisit the cost allocations after two years."

Dow says of Ofwat's response to this suggestion: "Ofwat has been robust in its response that the final determinations are done and that those margins therefore won't change. They have an opportunity in two years time to have a look at retail margins but what will happen there is, in effect, a rebalancing. So margins for individual customers or services may go up but others will have to come down. The average will still be 6%."

If the regulator won't budge on the margin issue, Business Stream isn't pretending it would walk away from England. But its ambitions may be reined in. Dow comments: "There is no getting away from the fact that we do have aspirations in the English market. It's a £2 billion market; it's seven times the size of the existing market in Scotland, so inevitably there are opportunities for us there. But at the end of the day if nothing changes and the average margins stay as they are, we will adopt a more targeted approach to customer acquisition."

Dow won't be drawn on exactly which types of customer would be most attractive to her company – because she says she

We don't believe 6% is enough to cover the cost to serve customers and to allow for discounts and for new entrants to invest in innovation and new services.

can't make that judgement yet. "In Scotland, we have experience of all types of customer. We have an awful lot of data and analytics on individual customer groups and what they want. But I would say that in the English market it is difficult to say 'it will be this group or that group', because we just don't have enough information to inform that at this stage. There are still lots of missing pieces of the jigsaw."

Common wholesale standards

The second issue that concerns Business Stream is the lack of standardisation in wholesale arrangements across the industry – in fact, says Dow, it is questionable whether you could even describe what is emerging as a single English market. She explains: "The issue at the moment is there are 18 different structures to wholesale charges and retail charges. So our concern is, when the market opens, we will still have 18 different structures of charging. And it's not just about charging structure. At the moment there are 18 different service levels that exist across those regions as well [for instance, how long it would take for a wholesaler to replace a faulty meter might vary between regions].

"So in effect, rather than just becoming one English market, what you'll have is 18 regional markets. That introduces complexity and with complexity comes cost. From a customer perspective, it jeopardises the expectations of multisite customers – they want one retailer who will supply them across the whole of the UK and I think that will be incredibly challenging."

To the best of Dow's knowledge, Ofwat isn't looking to harmonise the market. She appreciates the difficulty, observing: "Invariably, in order to insure any kind of harmonisation, there will be customers who are advantaged and others who are disadvantaged. We went through that in Scotland when the three regional water authorities came together as Scottish Water but in that instance the charging impacts were phased in, in order to minimise the impact for customers." But she feels common wholesale standards would keep costs down and enable single supplier deals to flourish. Business Stream would welcome any rationalisation even if that falls short of full standardisation, and argues that is would be perfectly possible to at least agree minimum industry-wide wholesale service standards.

Level playing field

Finally, Business Stream wants assurance the English playing field will be – at the very least – level. "In an ideal world our preference would be full separation in the same way as happened in Scotland," says Dow. There, she argues the playing field was in fact tipped in favour of new entrants – unique licence conditions were imposed on Business Stream to, for instance, prohibit selling at less than cost price and requiring it to publish details of the offers and deals it entered into with customers. So in an ideal world, similar conditions would be imposed on English incumbents.

But in the absence of full separation, Dow argues we need very clear rules set out to manage the interactions between wholesalers and retailers. This is on Ofwat's to-do list, but Dow would like to see more clarity, more quickly. "All we know so far is what Ofwat has shared. Companies that go for full separation will minimise the risk of non-compliance and challenge; for the others, risk will be higher. We would like to see real clarity from Ofwat on the licensing and reporting requirements for companies that adopt each of the various separation models. At the moment we have very little clarity at all."

She adds: "If there is no requirement for full separation, we would like to have similar conditions to those that were placed on ourselves and Scottish Water in place in England to ensure that incumbent retailers don't abuse their dominant position or benefit from their association with their retailer."

Looking elsewhere

Taken together, these three issues – margins, common standards and a level playing field – put Business Stream in a difficult position, affirms Dow. "What we're looking for is the ability to compete on a level footing with incumbents and at the minute we're not seeing that. That's not to say it won't happen, but at this point we need to highlight what our concerns are." It is doing so to Ofwat, Open Water and other stakeholders, and gradually collaborating more with other potential new entrants and customer groups who are likely to have a similar agenda.

However, with no guarantees on the table and in light of the risk, Dow is reassessing Business Stream's strategy for growth. "As a business, we've placed a huge amount of expectation on the English market to open in 2017 and that in some ways is based on an expectation that we could compete on a level playing field. As we get closer, it looks less and less likely that we're going to get exactly what we we're looking for. So from my perspective that means we can't afford to put all our eggs in one basket. The English market can't be the only part of our strategy for growth – we need other things too." She cites as one likely option growing Business Stream's value added services and water management offerings on both sides of the border.

Open Water

Dow has long been involved in the market design and development work being conducted by Open Water, initially on the programme delivery board and since November on the Open Water Markets Limited (OWML) board. She remarks: "I've definitely seen a lot of progress being made in the last six to nine months compared to what had gone before. I have to say that what Open Water and Alan [Sutherland] achieved there has been really significant. He has managed to engage with industry and drive the programme forward, and has gained acceptance for the fact that there are a set of codes and processes that exist in Scotland and while we can't pretend they're perfect, can we not at least use them as a starting point?"

Dow views it as inevitable that both Ofwat's new non-household retail director and whichever company ends up being appointed as the regulator's delivery partner in place of Sutherland and WICS will have to go through a period of learning and that any delay carries risk. "For me, every day is critical. Can the market open in April 2017? If there's any fundamental change to the programme delivery at this late stage I'd be concerned that there may be a knock-on effect on the date of market opening."

She is relieved that central systems procurement has at last got underway under Market Operator Services Limited's auspices. "The procurement of central systems is on the critical path. There needs to be real clarity about exactly what's required and realistic expectations about the extent of the design and build that we require. Equally we must allow enough time for a minimum of 18 different players to interact with the new system. All I can go on is my past experience in Scotland where we had to do something similar but with fewer players – there was only one wholesaler and only one structure of charges. Data quality was a big issue when the market opened in Scotland. I have absolutely no doubt that the same issues will pop out in England. The last thing we want is the procurement taking longer and the implementation and testing being squeezed at the end."

Given the choice, would Business Stream prefer come-what-may opening in April 2017, or a delay, should market preparation be inadequate? Dow points out that her first choice would be that a good quality market is opened on time. But if it is a trade-off between time and quality? "That's a real dilemma. We will have been waiting nine years by the time the market is due to open, so personally I am keen for it to open. However when I look at that from a customer perspective, it's got to be effective. If it opens and it was ineffective, customers could lose confidence in the industry. So I'd much rather it was done properly so when it opens it is effective – as long as that's not too far off in the distance."

Corporate strategy

Aside from reviewing the level of its reliance on the English market for growth, Dow says there will be little in the way of strategic change for Business Stream under her leadership, but that she has brought her own style and approach to the role. "Mark [Powles, previous chief executive who left abruptly last October after what is widely thought to have been a strategic split with the

We would like Ofwat to reopen both price determinations – retail and wholesale – to revisit the cost allocations after two years.

board] and I worked together for a long, long time so in many ways we have very aligned views. But I have a very different personality to Mark and a different outlook and that does influence the way we do things. For me, because I helped set up Business Stream, because I helped create it, I've got this absolute passion for it."

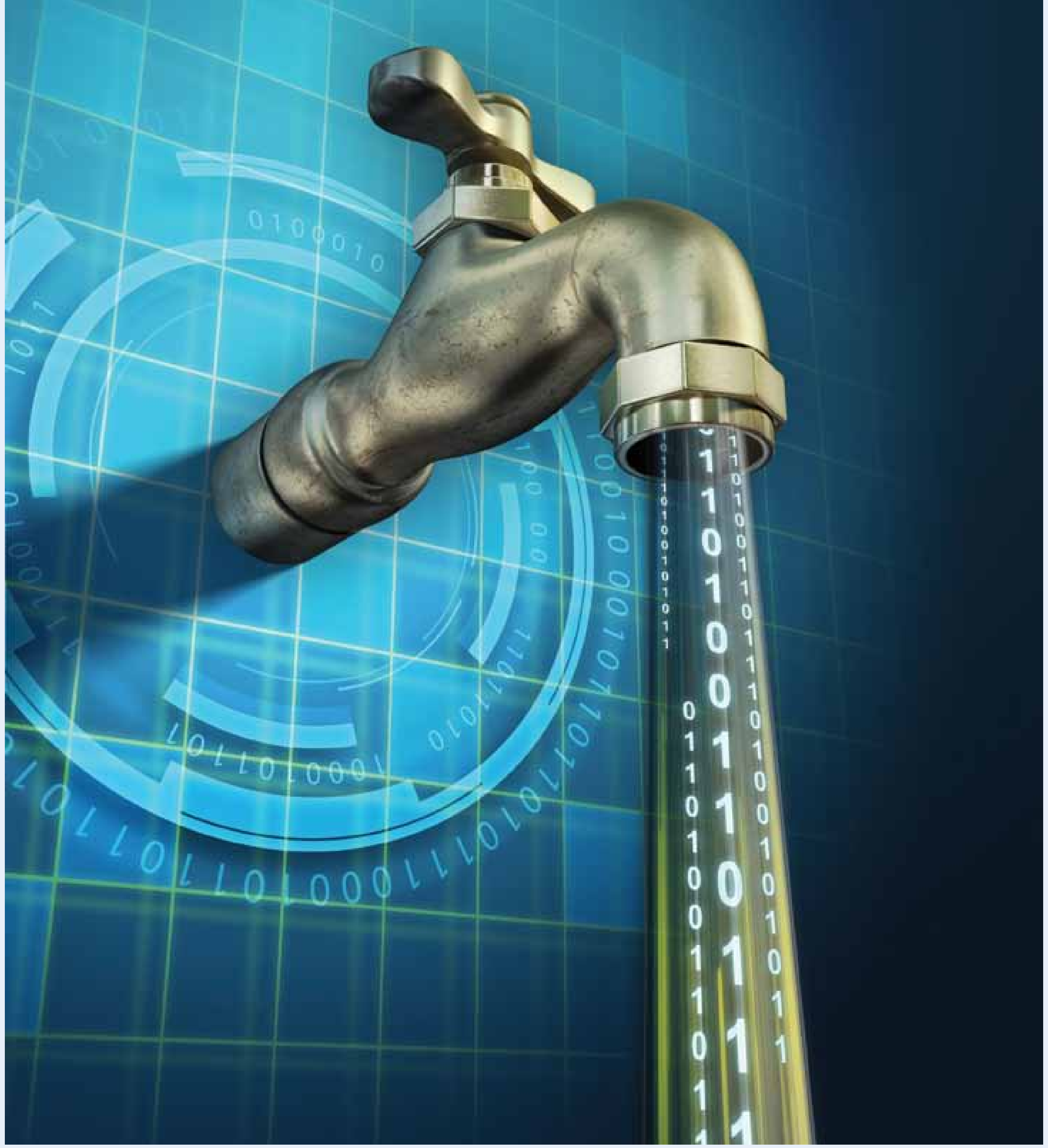
In Scotland, the company's priority will continue to be customer retention – an objective that has become considerably harder in the last year or so as both English incumbents and new entrants have piled in. Business Stream is potentially staring down the barrel of a major market share loss after Anglian Water Business was named preferred bidder for the £350m deal to supply water and wastewater services to the Scottish public sector. At the time of writing, award of the contract was at a "standstill" because queries had been raised and were being looked into. Dow was unable to comment in any way under the terms of the standstill arrangements.

Business Stream's strategy in England very much depends on how its three key areas of concern pan out ahead of 2017. It could be a wholehearted assault or a much more targeted approach. Dow says either way, Business Stream's key selling point is that: "We have a business that is entirely focused on customer service. We don't have an infrastructure to maintain. That's our big differentiator."

If market arrangements pan out favourably, mass customer acquisition when an incumbent exits is a distinct possibility. Dow mulls: "It's definitely on the radar for us. At the minute, we're looking at a number of different options on how we could achieve market entry. But there is a certain attractiveness in that [acquisition on exit] most definitely because in buying a customer base or indeed a retail company, it does give you an immediate presence and immediate foothold in the market." TWR

FEATURE | DATA READINESS

DATA FOR ENTRY



Companies are really up against it in terms of preparing their data for the retail market; must accept perfection is beyond reach; and should focus on mitigating risk.

Data proved a major problem in an otherwise pretty smooth transition to a competitive water retail market in Scotland. Although improving all the time, it remains an issue there today. In light of this, and of the far greater size and scale of the English market, it is widely recognised that cleansing and preparing data ahead of 2017 will be absolutely critical.

According to David Tyler of solutions specialist AMT-SYBEX, three main data tasks face water companies:

- Sorting non-household from household customers. Tyler describes the fact that English companies have a direct billing relationship with domestic customers as the "saving grace" of the English market compared to Scotland, where no such direct relationship existed. "There is a far better chance of taking in 100% of the market," he explains, "so it will be more a matter of deciding where to draw the line between households and non-households." (See report on eligibility, p20)
- Ensuring existing non-household data stands up to scrutiny. "Companies will have to sweat their existing data, such as meter data," Tyler observes. "Problems that you can get away with in a monopoly situation won't be tolerated by competition."
- Plugging gaps. Even though English company data should be reasonably comprehensive, there will still inevitably be holes. Moreover, the market will make entirely new data demands of companies because of the new processes in play. Tyler cites as an example unique property reference numbers.

In itself, preparing data for competition will be a major undertaking. But to make it even more challenging, while an industry-wide consensus is ultimately desirable, each incumbent water company needs to grapple with the issues independently. According to Tyler, it soon became apparent that Open Water's early exploration of a centralised, top-down way of defining the market would fall short given the many data types and styles in the sector. Consequently, companies have been charged with coming up with something workable.

Anxiety and uncertainty

While this is an understandable and practical approach, Tyler notes it is causing anxiety in the industry. "Many had hoped to get a firm steer but they are actually feeling quite exposed," he says. "And they can't quantify the scale of the cost." He acknowledges the publication of a first draft data catalogue alongside MAP2 was a "significant milestone" and helpful in setting out what players will ultimately need to do to transact in the market and hence where their immediate priorities should lie. But as the data catalogue is not in any way prescriptive on how companies should get from A to B, working out the practicals still falls to the industry.

This sense of exposure and anxiety has been little helped by ongoing delays and repeated changes to Market Operator and central systems procurement arrangements. Understandably, says Tyler, companies have been reluctant to commit to a data preparation programme without absolute certainty on what exactly will be required. As weeks of delays have become months and the programme timetable has become more and more squeezed, companies could well be forgiven for wondering whether the April 2017 deadline will be hit or, probably more accurately, how full the market that is opened on that date will be.

Tyler observes: "If MOSL [the private sector company now undertaking central systems procurement] lands a tender on time, and if MAP3 comes out as planned, most companies will be ready to move as they will already have formed a view. But they haven't wanted to commit themselves as yet. Particular issues have been who would bear the risk of change – the company or the system implementor? And how should areas that are most at risk of change be managed?"

He adds that one silver lining to the delay and long drawn out process has been that companies have started to progress their thinking beyond what data actions are needed for minimum compliance on day one of the market, to what they might need to do to retail and/or wholesale in the market in a more ongoing way. "Some have used the time to think more about their future operations," remarks Tyler. "About how they might set themselves up to be responsive, flexible or innovative."

Emerging collaboration

He observes too that in the absence of extensive central direction from Open Water or Ofwat and in the months of wait, some companies have voluntarily started to work through the issues together. "There is emerging collaboration," Tyler mulls. "Clusters of companies seem to be talking to each other. There is also evidence of indirect collaboration through service providers in the sector who may be working with more than one company or who have experience of similar projects in other markets."

Forward thinking retailers will also have been using the time over the last six months to ingratiate themselves with their customers by more active account management, which should have included working with them to build an accurate picture of their sites, supply points, meters and consumption data. Failure to do so could in fact risk the retailers having to break any promises they make on post 2017 bills or service levels. Tyler recalls that in Scotland, some customers' bills actually went up as a result of market opening, as closer data scrutiny revealed they had been underpaying or not billed at all for particular sites or services.

Customers themselves, particularly large multi-site consumers keen to take advantage of the single supplier prospect the market offers, have a role to play in ensuring their data is accurate ahead of switching. Tyler notes that in practice though, it can be tough for customers to get the ball rolling. A national retailer, for instance, would have to liaise separately with up to 18 incumbents. Tyler suggests: "This is something that could be encouraged and instructed centrally. Ofwat could have a role informing customers what they could usefully do and how."

Risk mitigation

Clearly, whatever way you cut it, the water industry is staring down the barrel of a problem of enormous scale and complexity. Tyler remarks: "A very steep rise in data quality seems likely to be required, and there is an ocean of data to deal with." In view of this, his company advocates a practical, prioritised approach to data preparation; an approach that inherently accepts perfection is beyond reach and hence that attention should be focused where it is most needed.

AMT-SYBEX has identified six key data quality risk factors against which it can compare a water company's data. From this, says Tyler, "we can generate a set of risk scores that predict which areas of the data are likely to need the most attention. Next, we assess which of those areas are most critical for Open Water

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compliance, and whether they will be required from day one of Open Water or can be phased in later." From this, a pragmatic, logically-prioritised data-tackling strategy can be derived. The six key risk factors are set out in the box.

Difficult start

So how does Tyler assess the industry's chances of being data-ready for market opening in April 2017? "I don't think data in itself will be enough of a problem to delay opening. There is a great deal of focus now on big ticket items, such as the properties that are actually in the market. If all the codes and central systems are in order, people will proceed.

"But I expect the first 12 months to be bumpy. It will be a period of stabilisation where gap sites are identified and water companies and data consultancies will work to put sites into the market. This will mostly be a case of reclassifying household premises as non-household premises, rather than adding completely excluded sites. Data will also cause market operating inefficiencies and exceptions. It will slow the rate retailers can take on customers. If 10% of a multi-site customer's sites don't go through, there will be transfer reversals and consequences for retailers. It will be messy and could have reputational issues for the market.

"But the data issues will be worked through in time. Two to three years down the line, it will be a very different picture."

Does Tyler think incumbents should be incentivised to ensure their data is of good quality? A fine line must be trod, he says. "The market should be careful about penalising incumbents for data captured many years ago before the requirements of competition were even thought about. That said, retailers will suffer if quality is bad – things like abortive site visits can be expensive. Open Water looks likely to go soft on this; there are no penalties [on data quality specifically] in the Scottish market and no mention of them in MAP2. But I think there ought to be an aspiration to tighten data in the long run." He offers for consideration: "There could be a soft landing period of three to five years, so the wholesaler has the opportunity to improve data quality organically before a liability kicks in.". TWR

SIX KEY RISK FACTORS FOR WATER COMPANY DATA QUALITY

1. Source suitability: Is each item of data being taken from the system where its master record resides? Or is it coming from a downstream system, where errors may have been introduced? If the latter, the risk of low data quality is much higher.

Tyler says most companies are sourcing market data from their billing systems, which is an understandable choice given these are customer-facing. He suggests, however, that the asset management system would be a better choice: the "true authority," unblemished by processes and changes billing system data may have been subject to. Asset management system data is particularly valuable for the wholesale parts of companies going forward, which will no longer be operating billing services directly. Should billing and asset data not match, cleansing will be needed before billing data is disregarded in favour of asset management system data.

Tyler says it is "quite a leap" for some companies to accept this thinking, as they trust their customer-facing billing data more – particularly those who plan to keep their wholesale business together with their domestic retail business going forward. However, he advises that even for such companies, "connecting the asset management system to the market is sensible, and will future proof the business against potential future changes such as the introduction of domestic switching".

2. Data architecture: How did the data get into water company systems in the first place? Does the data have integrity or does it depend on "leaps of faith" – for example, relying on the data captured by the technician who installed the meter, without cross-referencing it against the meter manufacturer's own datasets? The latter is a warning sign that this data may need to be examined more closely.

Tyler observes that many water companies currently rely on data generated by work carried out on customers' sites and that he would "paint a fairly negative picture about the level of accuracy of such data". He notes that in energy, job-based information is rarely trusted, with meter installers commonly required to scan the meter's bar code so there is a foolproof record of the type of meter installed from which other relevant data - for instance, when a replacement will be due – can be gleaned. He says competition in water will demand job-based records are tightened up.

3. Data completeness: How complete is the data-set, and how much duplication does it contain? How well does it conform to a valid set of values? If it doesn't, that's another red flag for data quality problems.

As noted earlier, the fact that Scottish Water had a "household blind-spot" that English companies don't have should significantly help with the issue of data completeness. Beyond that, there will be variance company to company. Tyler relates that one company he has been involved with has a data set that is "almost ideal for the market": good quality information that goes down to a granular level. Even in multi-use and tenanted properties and with housing assocations, this company has information on both the billed entity and individual users. "But the industry more widely will struggle to marry up their financial records (ie from bills) with the physical relationship between properties within collective sites. There will be big gaps on granularity."

4. Rarely used data field records: Has a given data field always been used for the same purpose, or has it spent different periods being used to capture different things? Users will often pick a rarely used field and commandeer it to store information for a special project or temporary requirement. This overwrites the existing data, so it's a potential problem if that particular field needs to be used in an Open Water dataflow.

5. Ease of correction: If errors in a particular field are easy for users to correct, it's more likely that they will have fixed them already. If the market catalogue asks, for instance, for a street name and the company has only a house number and postcode on file, it would be very easy for it to source the street name using Post Office files or equivalent. On the other hand, if a piece of data can only be verified and updated by visiting a site and checking it manually – for example, the serial number of a meter – it's more likely that the error will go uncorrected.

6. Coding data: Some types of data, such as dates and postcodes, are likely to be in the right format to interact with the market already, or at least should be easy to convert into whatever format Open Water finally specifies. But for other types, the transformation process itself is likely to be more difficult and error-prone. For example, the location of a meter on a site may need to be expressed as a code, whereas in many current datasets, meter location is described in a free text field. Converting the text into codes could perhaps be achieved using automated text analytics – but the results won't be perfect, and the error rate is likely to be high.