Financial Regulation of the Water Industry in the UK – 2015 onwards

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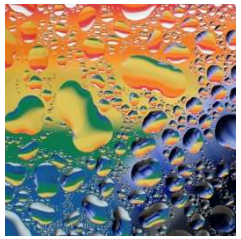


PR14 – a clarification

- **Water Industry Commission Scotland** (WICS) – Strategic Review 2015 (SR15) 2015 to 21
- **Northern Ireland Utility Regulator** (NIUR) – Price Control 2015 (PC15) 2015 to 2021
- **The Water Services Regulation Authority (Ofwat) –** 5 yearly Periodic Reviews of prices. PR14 will set prices for the period 2015 to 2020.

Shared future challenges

- Affordability
- Greater customer expectations
- Climate change mitigation and adaptation
- Greater environmental protection
- Population growth (+9.6m in next 25 years) and lifestyle changes

Affordability

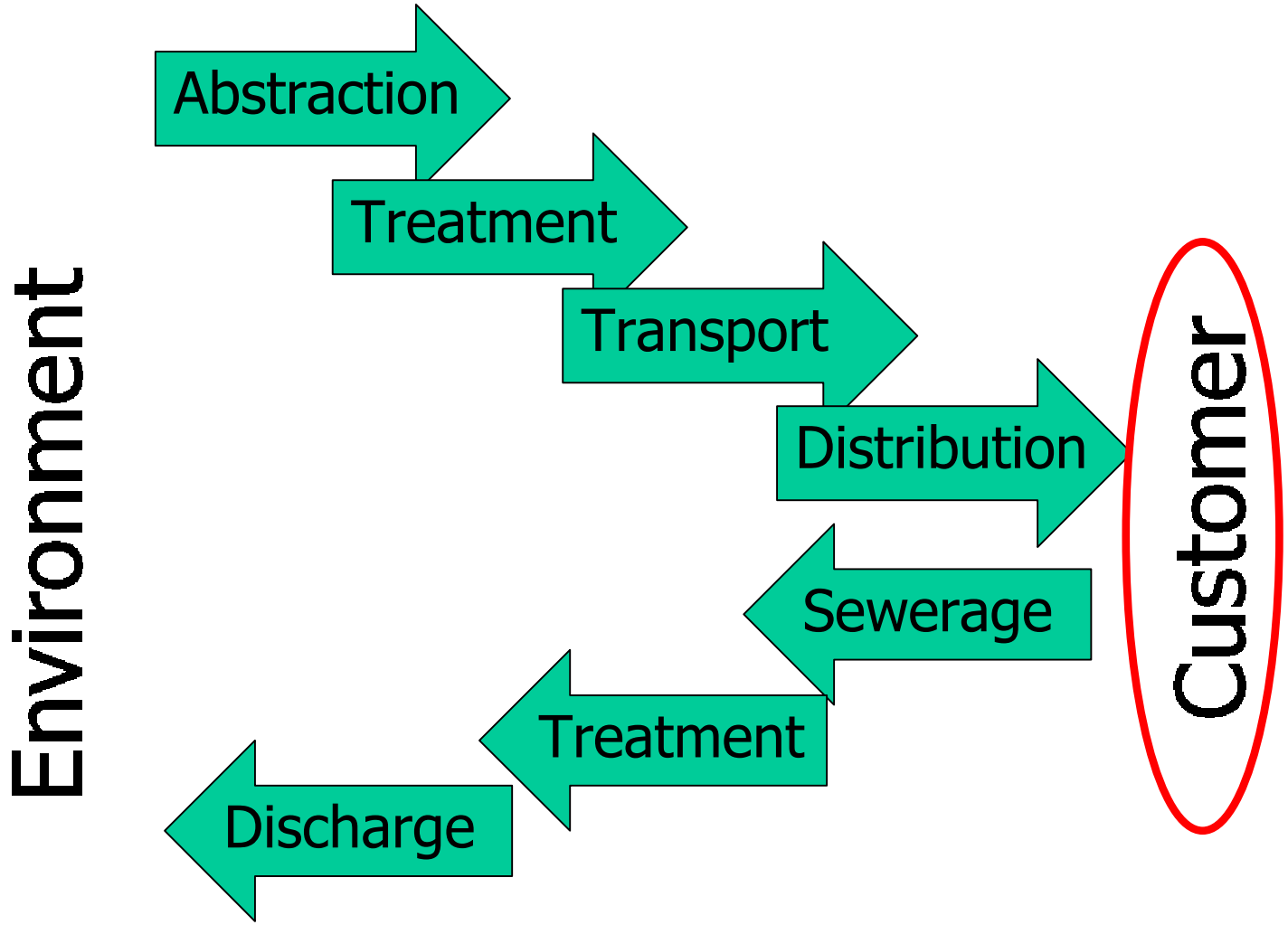
Water Bills: Minister Urges Curb To Hikes

In a letter to water suppliers, Owen Paterson calls for a fair deal for customers as the average household bill nears £400.

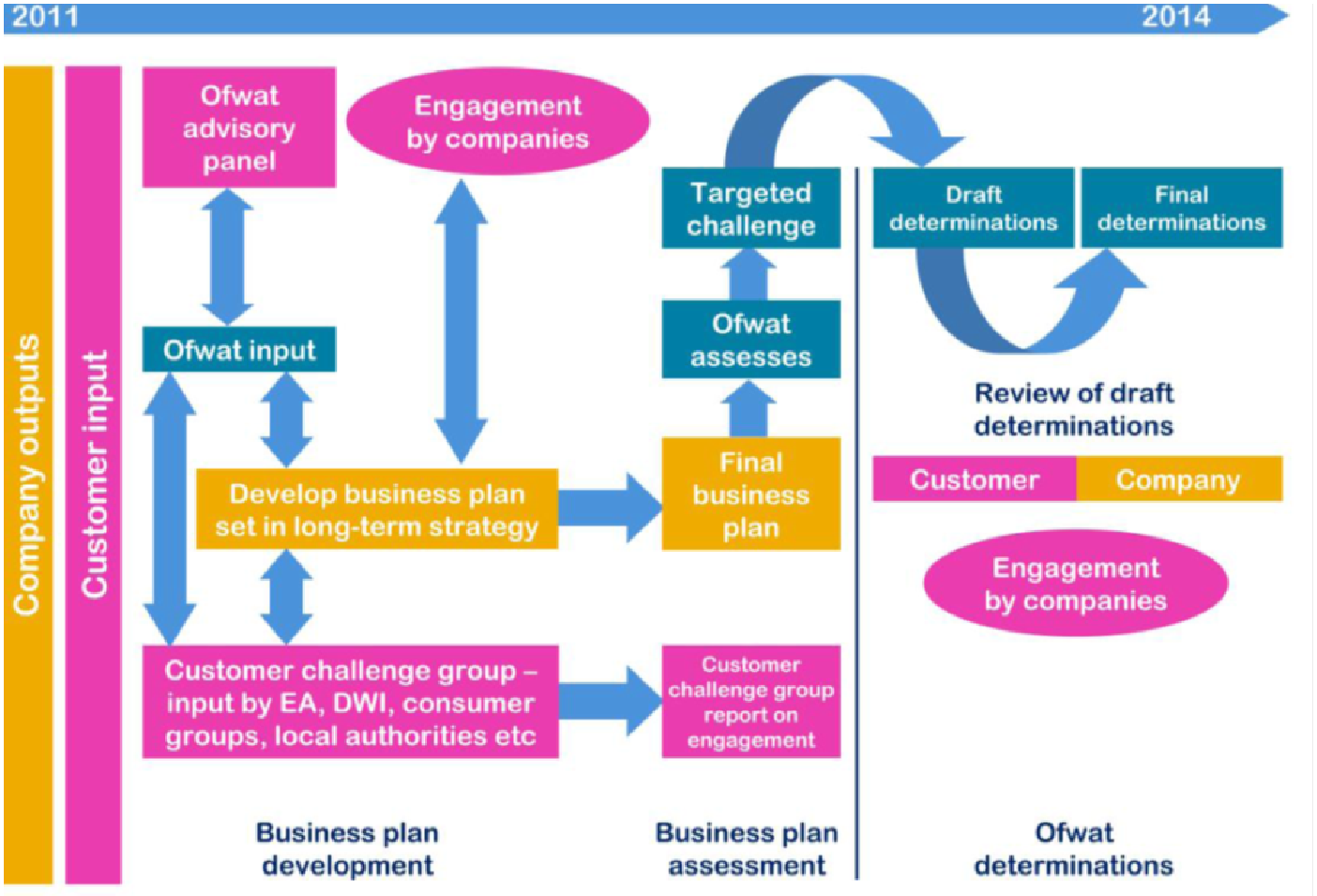
9:50am UK, Tuesday 05 November 2013

Source: Sky News website 5 November 2013

Customer focus



Customer focus - embedded in the process



Customer Challenge Groups

- independent local groups of customer representatives and other stakeholders
- ensure that local and regional issues are properly considered and that the views of the company’s entire customer base are taken into account

Incentive to embed customer involvement

- High quality business plans…some criteria
  - is designed to deliver good outcomes for current and future **customers** and the environment;
  - has a coherent narrative based on sound reasoning and contains proportionate evidence;
  - will ensure that a company meets its statutory obligations and enables the relevant regulators to confirm this in the **customer challenge group** (CCG) report;
  - is based on good-quality engagement with **customers and consumers**, and the results of this engagement are reflected in the proposed outcome commitments, and the plan more generally;
  - is cost efficient, containing accurate projections and estimates;

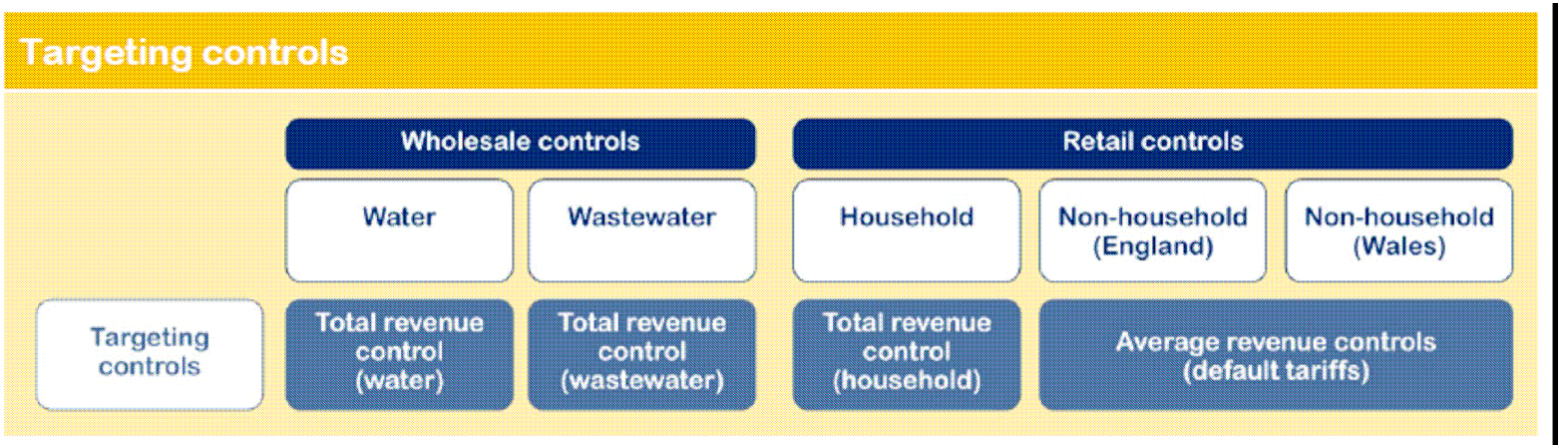
Risk-based review of business plans

- Assignment of elements of plans and each company to one of three processes:
  - **enhanced, standard or resubmission**
- This determines the likely level of scrutiny and challenge of that element
- Determines **procedural, reputational and financial benefits**.

Benefits of a ‘high quality plan’

- **Procedural**
  - risk-based scrutiny of plans
  - Higher quality; less scrutiny
  - Early draft (and potentially final) determinations
- **Reputational**
  - Publishing classification of plans provides a reputational benefit
- **Financial**
  - Access to greater share of cost outperformance
  - ‘Enhanced’ category companies better off than those in ‘standard’ category

Price setting – PR14



- Preparing for competition in the non-household sector in England
- Announced in the Water Bill in 2012

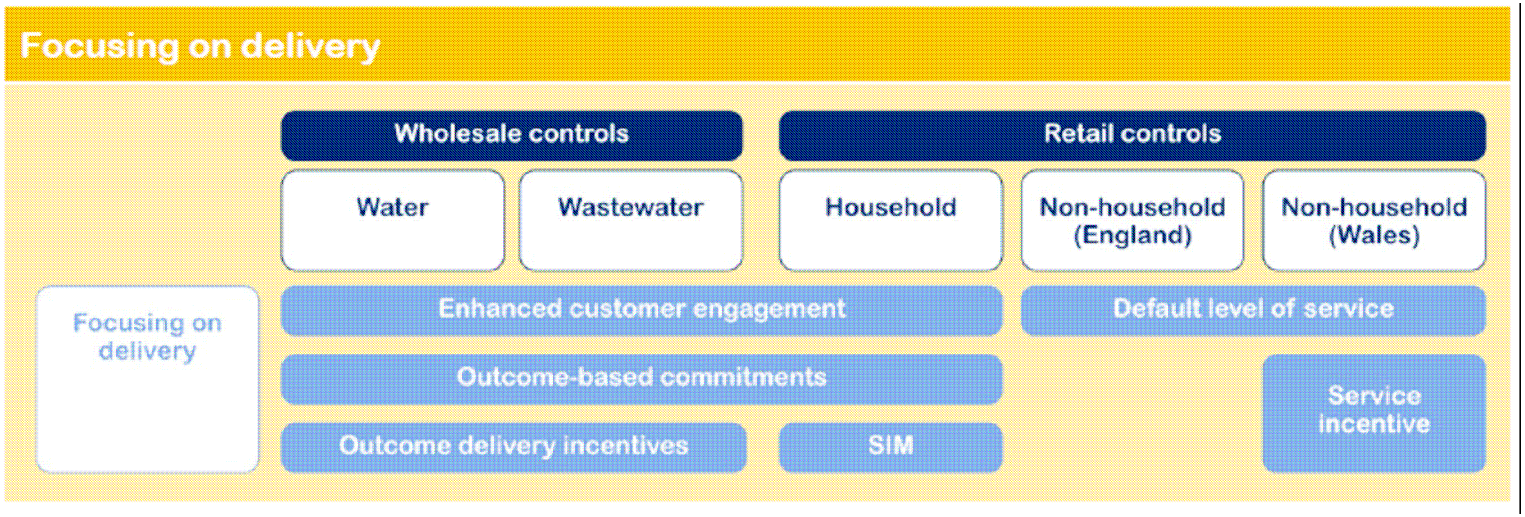
Targeting controls

- **Wholesale**
  - RPI+/- K for water and wastewater (separate K factors)
  - Provides consistency and access to low-cost finance for asset intensive business
- **Retail**
  - Total revenue controls for households
  - Average revenue controls for non-households by sector
  - Aim to cover all reasonable costs and a reasonable return

What is ‘Retail’?

- ‘Retail’ [selling water to customers] includes:
  - Customer services
    - Billing and payment handling
    - Vulnerable customer scheme
    - Enquiries and complaints
  - Debt management
  - Meter reading
  - Other operating costs
    - Water saving incentives
    - Scientific services
    - Customer side leaks
  - Developer services and Local Authority Rates

Focus on delivery – ‘outcomes’



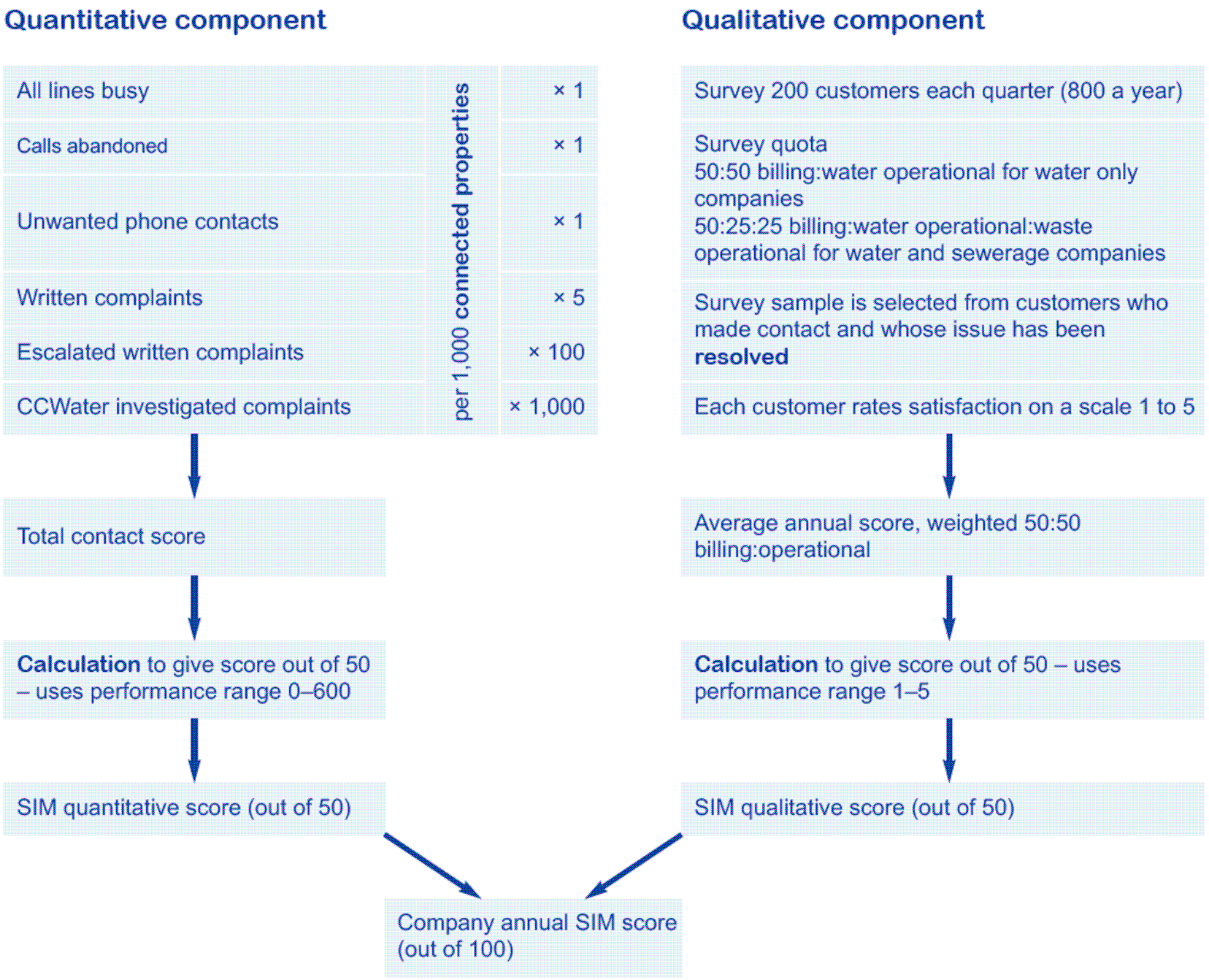
- Ofwat less prescriptive to encourage innovation and greater ownership of Business plans by companies
- Focus on **what** needs to be achieved and not on **how** to achieve it

Incentives for delivering ‘outcomes’

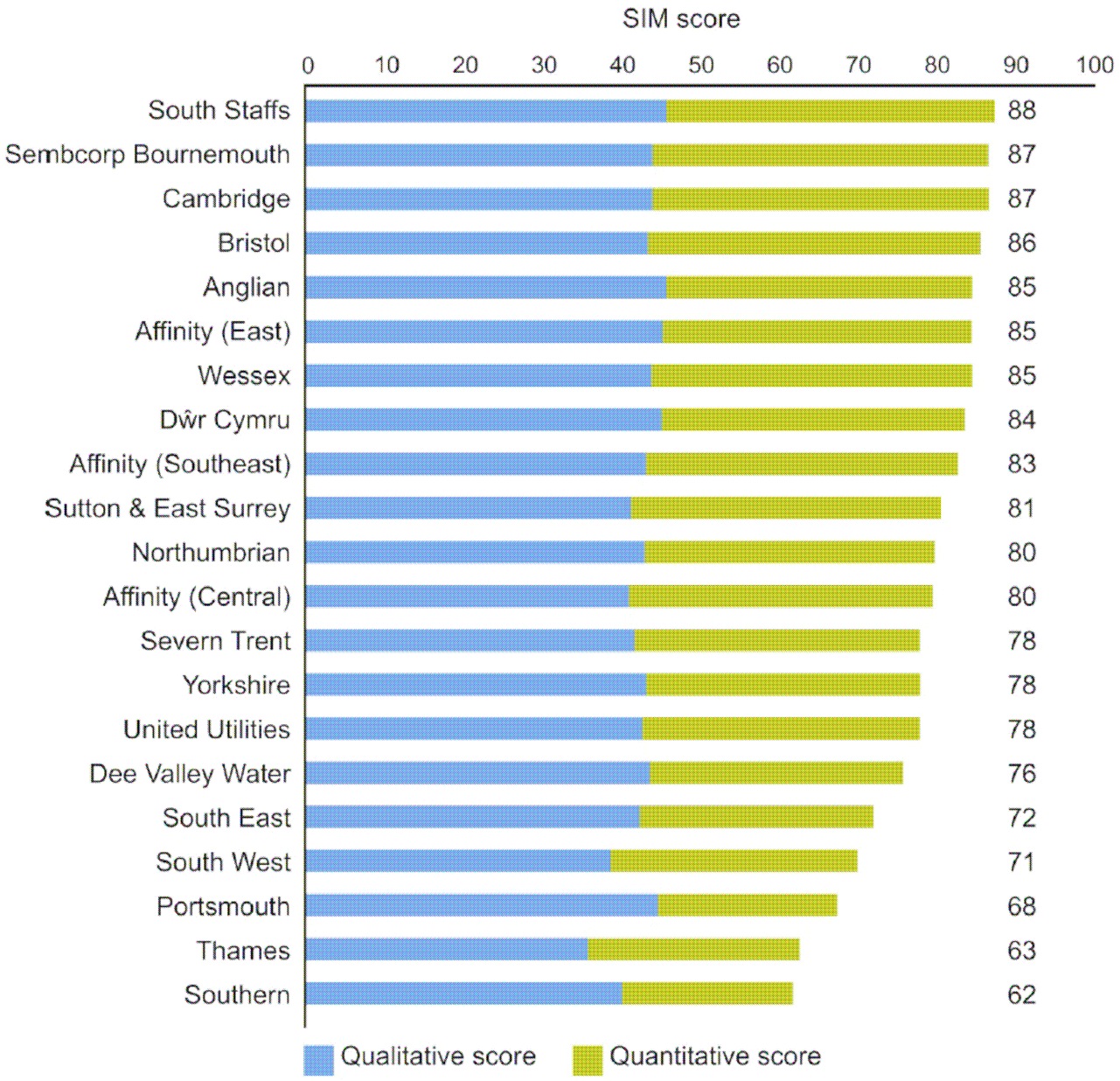
- **Wholesale** - Outcome Delivery Indicators (ODIs)
  - to be proposed by companies in each plan
  - To reflect value of outcomes delivered to customers

- **Retail** (household) – Service Incentive Mechanism (SIM) (under review for PR14)
  - A measure of service deliver to customers and customer satisfaction
  - Companies ranked according to SIM score and financially rewarded (+0.5%) /penalised (-1%)
  - Reputational and financial incentive
  - ODI for leakage

Summary of SIM components and outline calculation



SIM scores – 2012-13



Leakage

- One remaining issue of high customer concern
- Ofwat will continue to enforce leakage reduction targets

Value for money

Total Expenditure – TOTEX – approach to reduce bias on capital intensive solutions

Catchment management – a less capital intensive solution

- A way of managing land and water in a coordinated way.
- Characteristics:
  - Catchment-scale focus
  - Holistic view
  - Working with natural processes
  - An integrated approach
- ‘attempts to balance competing human demands on a catchment in a way that enables immediate human needs to be met without eroding the natural of the system thus allowing future human needs to be met’

Catchment management and the UK water industry

- Some water companies have large land holdings - Direct responsibility for land management
- Recognise the link between land management and provision of drinking water
- Catchment interventions to reduce pollution (pesticides, nutrients, turbidity, colour) can offset increasingly cost and carbon intensive treatment.
- PR09 – Ofwat relaxed requirement for investment on company-owned land
- PR14 – Ofwat, environment and drinking water quality regulator support catchment management

Catchment management in PR09

- Focussed on drinking water catchments
- Address colour from upland degraded peat
  - United Utilities – SCaMP
  - Yorkshire Water
  - Severn Trent Water
  - South West Water – Upstream Thinking
- Over 130 catchment management schemes funded in PR09 – colour, nutrients, pesticides

Examples……

Nutrients

•Nitrate in chalk groundwater aquifers – Wessex Water

•Phosphorus in rivers from livestock farming – South West Water – Upstream Thinking

Pesticides

•Wessex Water; Essex and Suffolk Water; Thames Water – all attempting to reduce pesticide levels in raw water by encouraging good practice on farms

•Metaldehyde – treatment solutions ineffective; requires a catchment management solution

Business case for water companies

Costs and Benefits – compared to treatment

- Costs
  - Reduced capital costs
  - Reduced operational costs
  - Less energy/carbon intensive
  - Opportunity to share costs

- Benefits
  - Reduced effectiveness
  - More risk; less control
  - Wider benefits – biodiversity, carbon sequestration, flood protection, water resource management
  - Delivery of multiple environmental outcomes

Catchment management for PR14

- Supported by all regulators – environment, nature and drinking water quality
- Popular with customers
- Sound business cases
- Addressing more objectives….water quality AND….
  - Flood protection
  - Water resource management
  - Enhanced compliance at bathing and shellfish waters
  - Securing dilution capacity/reducing wastewater treatment costs

UK water industry regulation – achievements to date

- Water security enhanced
  - £100 billion invested since 1989 (£55 billion from company debt; £22 billlion in PR09)
  - Leakage reduced
  - Higher level of customer satisfaction
  - Water bills increased – 45% in real terms since 1989
- Environmental quality improved
  - Pollution from water company assets reduced
  - Abstraction remains a challenge
- Drinking water quality improved
  - Consistently high drinking water quality delivered to tap

Future improvement anticipated

- No increase or reduction in water bills (for PR14) ‘or the companies will explain to their customers why’
- Further investment in infrastructure
- Greater customer engagement to drive improvements in service
- Steps towards introducing competition to drive improvements in service
- Further reductions in leakage
- Further environmental protection