



# Delivering results for water customers in Wales

March 2014



## Contents

|  |    |
|--|----|
| Executive Summary                                    | 1  |
| Section 1: Background and Context                    | 7  |
| Section 2: Methodology and Research Design           | 13 |
| Section 3: Review of Existing Evidence Base          | 14 |
| Section 4: Scenario Development                      | 22 |
| Section 5: Stakeholder Engagement and Feedback       | 27 |
| Section 6: Multi-criteria Analysis                   | 35 |
| Section 7: Research Findings and Discussion          | 41 |
| Section 8: Recommendations                           | 51 |
| References   | 53 |
| Appendix A: Approach to stakeholder engagement       | 55 |
| Appendix B: Multi-Criteria Analysis Approach         | 58 |
| Appendix C: Existing Evidence Base – Further Details | 78 |
| Appendix D: Stakeholder feedback – Further Details   | 85 |

## Executive Summary

This research project was commissioned by the Welsh Government to explore opinions and views on the future provision of water and sewerage services in Wales in relation to business (non-household) customers. The research has included a review of available evidence and stakeholder engagement to understand the needs of business customers and how these could be met whilst also achieving the social, environmental and economic outcomes sought by the Welsh Government. The proposed and potential water market and regulatory reforms have been assessed and compared to the existing (baseline) regime in Wales to assess whether reform would be in the best interests of water customers in Wales.

### Assessing future needs of business customers

A review of existing evidence, combined with stakeholder and business customer telephone interviews, online questionnaires and workshops, has identified the key priorities and needs of business customers for the future provision of water and sewerage services.

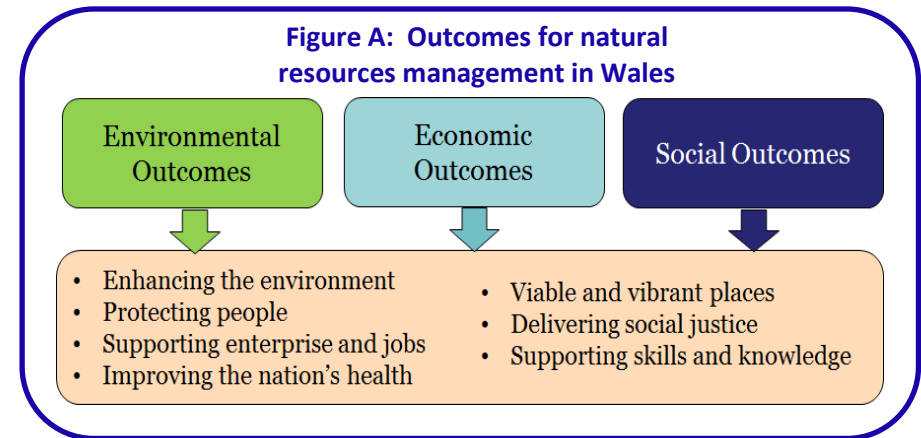
Views were also sought on the outcomes set out by the Welsh Government for natural resources management in Wales (Figure A) and the relative importance of each of these to their business, supported by information on how each outcome links across to water and sewerage services.

### Review of existing evidence

A review of existing evidence focused on the following areas:

- Proposed water regulatory changes in Wales and England, including Ofwat's reforms and the Water Bill
- Experiences and lessons learned from retail competition in Scotland
- Water regulatory regimes in other European states

- Existing data and research on the needs of business customers in Wales
- Experiences from other utility sectors in the UK



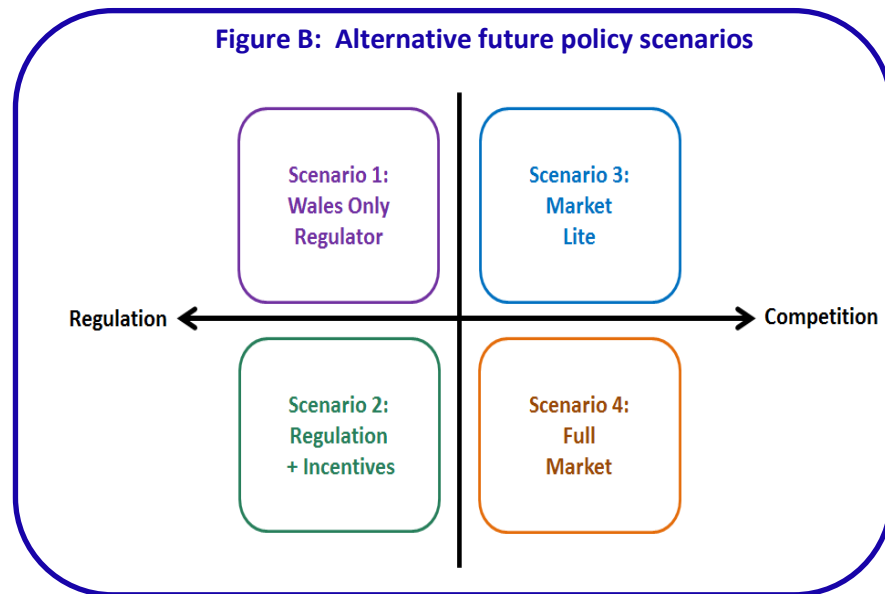
Key findings from the review were:

- a) Business customers are a diverse group, with wide ranging requirements but key priorities are value for money services, good communication channels and flexibility of approach on billing services and tariffs.
- b) Business customers of Dŵr Cymru Welsh Water considered that the 'not-for-profit' business model of the parent company Glas Cymru ensured a focus on customers and reduced the perceived benefits of competition
- c) Retail and wholesale competition is not a feature of water regulatory models in other European nation states, with concession contracts from public authorities a common feature.
- d) There is little direct evidence available of the benefits of retail competition beyond the experience in Scotland.

e) Experience from retail competition Scotland indicates that since 2011, 13 licensed retailers have entered the market. Whilst only 5% of business customers have switched supplier, 50% of the market (approximately 45,000 customers) has renegotiated their water and sewerage services. Non-household retail operating costs have been reduced by the dominant retailer (Business Stream) in the same timeframe. There has also been a focus on added value services.

### Scenario development

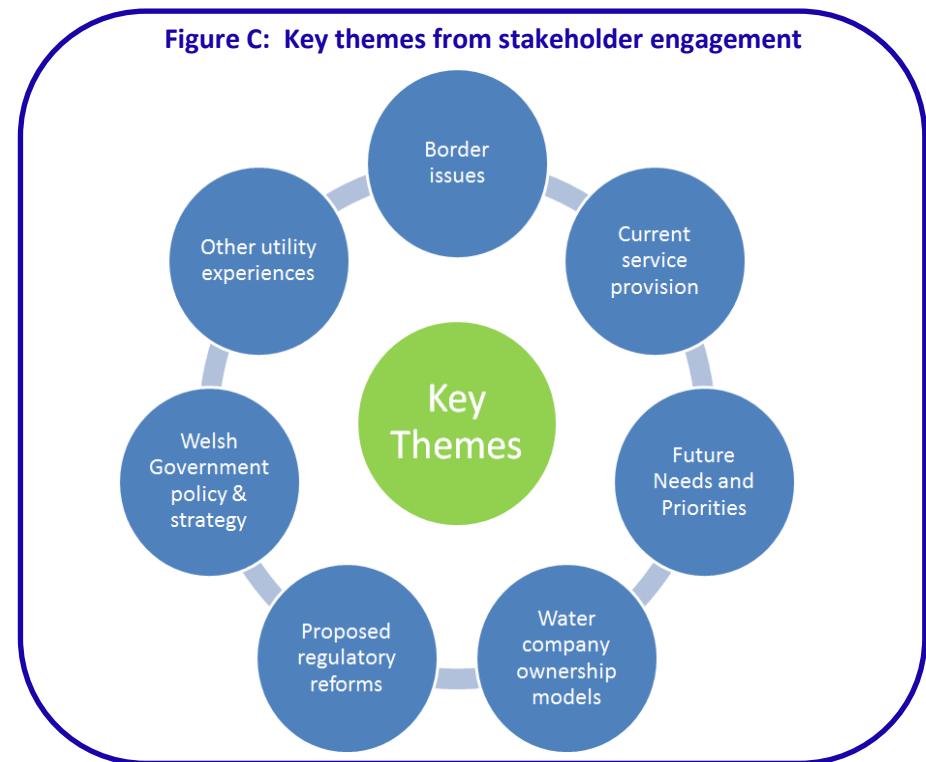
Based on a review of the current legislative and regulatory environment and alternative administrative models, four scenarios were developed to represent a realistic range of potential options for managing water and sewerage provision within Wales (Figure B). These scenarios were used to help facilitate stakeholder discussions and also a vehicle for assessing the advantages and disadvantages of different regulatory regimes.



Each scenario relates to existing examples in the UK water industry, or to proposals for alternative models to be introduced in the future. A common set of themes were identified to provide a framework of principles within which the scenarios were characterised. As illustrated in Figure B, the scenarios were developed along an axis representing the poles between a highly regulated water and sewerage market and an open, fully competitive market with only modest regulatory oversight.

### Findings from stakeholder engagement

The key themes emerging from the stakeholder engagement (Figure C) chimed with the findings from other engagement activities carried out with business customers by water companies, Welsh Government and the Consumer Council for Water.



There was generally a good degree of alignment between the needs of business customers and the Welsh Government’s outcomes, particularly in relation to:

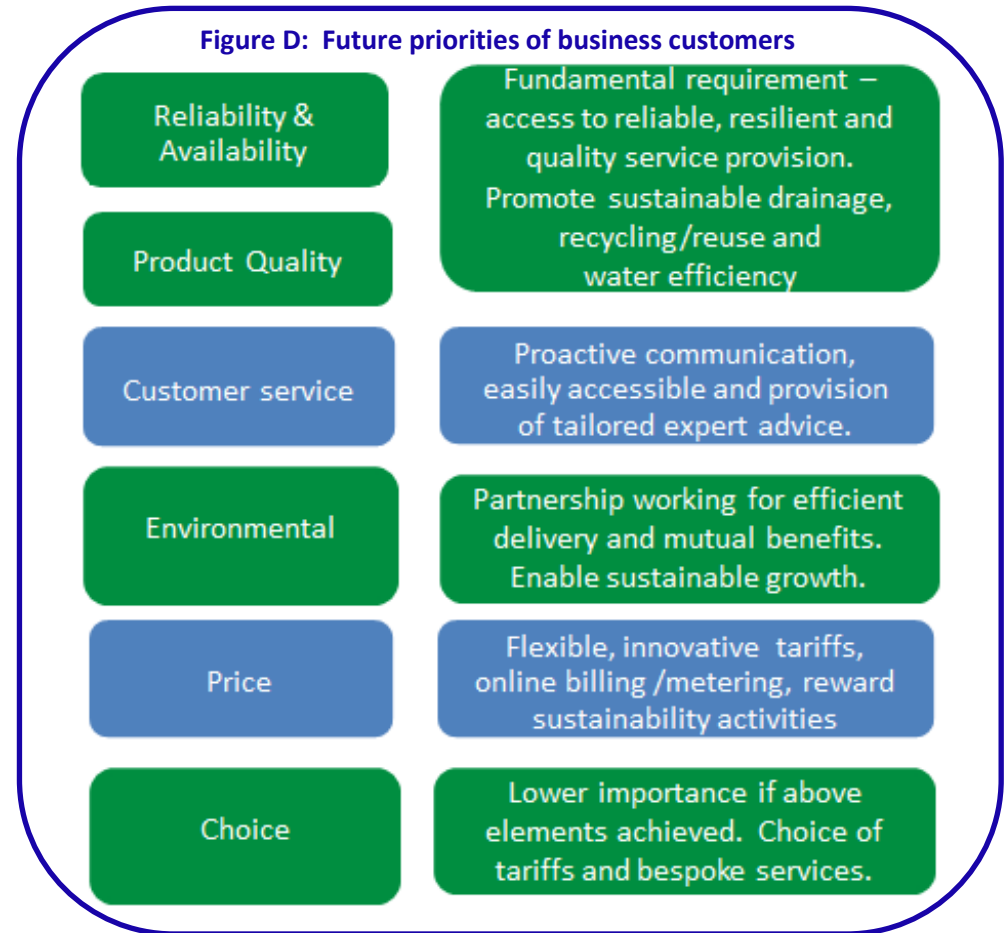
- **protecting people and improving the nation’s health:** focus on resilience and security of water and sewerage services, prevention of surface water flooding and maintaining high standards of drinking water quality
- **Enhancing the environment:** focus on improving the local environment in order to support sustainable development and jobs, engender tourism growth and provide wider opportunities for local businesses, local authorities and community groups to work in partnership with water companies for mutual benefit
- **Viable and vibrant places:** focus on addressing river and bathing water quality to drive tourism and recreation, reduce the risks of surface water flooding and pollution to encourage inward investment and development opportunities. Ensure infrastructure capacity is not a constraint on development.

Businesses value the benefits that water companies can provide in relation to sustainable water and sewerage provision and are therefore supportive of policy developments that help bring a greater focus on delivering these outcomes. Most business customers are reasonably satisfied with the service they currently receive. Stakeholder feedback has not shown a strong push for significant reform, but rather evolution to improve the focus on customer priorities has been the main message along with greater flexibility to tailor services and tariffs, as well as providing easily accessible technical support and communication. From the feedback and discussions, the key future priorities of business customers were identified (Figure D).

The not-for-profit model of Dŵr Cymru Welsh Water has generally been supported by its business customers, but there is a particularly strong pull for greater engagement with businesses, including in relation to:

- New connections and new development

- Sustainable drainage and sewerage systems
- Partnership working on environmental issues
- Provision of greater technical advice and services



Building on these priorities, engagement with stakeholders helped to identify a range of policy actions to support delivery of these priorities (Figure E) and the development of a set of recommendations.

Figure E. Policy Actions

## Support for sustainable new developments

- \* Greater engagement with developers & local authorities
- \* Innovative, sustainable water & sewerage solutions
- \* Address barriers to inset appointments & developers

## Rural communities

- \* Improve access to public water & sewerage systems
- \* Integrate measures with other rural infrastructure provision
- \* Partnership working with agricultural & land managers
- \* Application of market-based instruments

## Sustainable drainage

- \* Clarify ownership & responsibility for drainage assets
- \* Resolve regulations on SUDS
- \* Encourage partnership funding & collaboration between drainage system owners

## Tariff innovation

- \* Regulatory reform to enable greater tariff flexibility
- \* Greater incentives/rewards for water efficiency, sustainable drainage, recycling and reuse
- \* Tariff innovation to better reflect business requirements

## Encourage Innovation

- \* Consider innovation incentives for water companies & supply chain
- \* Encourage innovative solutions between business customers, public sector bodies & water companies
- \* Maximise use of technology funds

- \* Encourage extension of water efficiency labelling
- \* Innovation in leak detection
- \* Greater advice and services for business customers
- \* Greater integration of water and energy efficiency services

Develop capability:  
Wales as a centre of excellence for water management

## Recommendations

In developing the water strategy, the Welsh Government has set out clear outcomes for Wales. Any changes to the water regulatory regime must therefore be developed to support achievement of these objectives, which have a broad social, economic and environmental basis. Decisions also need to acknowledge that the dominant incumbent water and sewerage company in Wales has a 'not-for-profit' business model.

Evidence from business customer stakeholder engagement has shown that there is close alignment between business customer priorities for water and sewerage services and the Welsh Government outcomes. This alignment provides confidence that measures proposed to meet the Welsh Government outcomes are also likely to meet those of business customers.

### It is recommended that:

1. The existing regulatory regime and those proposed by Ofwat to come into force from 2015 for companies wholly or mainly in Wales (and those for Severn Trent Water aligned to changes in England) should form **the basis** of any future changes to the water industry regime.
2. The Welsh Government should seek devolution of sewerage legislative competence to address this current anomaly, building on the recommendations of the Silk Commission (2014).
3. The largest business customers using greater than 50 million litres of water per year should be able to choose their retail sewerage provider as well as their retail water supplier.
4. The current volumetric consumption threshold for business customers choosing their retail water supplier should be retained at 50 million litres per year.
5. Additional measures to encourage and further evolve the Inset Appointment/NAV process should be considered, particularly in the context of innovation and integrated solutions for energy and water, sustainable drainage and wastewater treatment. This includes lowering

the large user threshold for inset appointments for single sites to 50 million litres per year. The benefits to customers from inset appointments should be made more explicit and transparent in applications. This would also continue to provide regulated competitive and reputational pressure on the incumbent water companies to help drive efficiencies and customer service improvements.

However, before further steps are taken to encourage further inset appointments, the regulatory issue relating to the governance of appointees needs to be resolved. A company whose first inset appointment is made in England continues to be regulated by the UK Government even though it could subsequently apply for and operate inset appointments in Wales in the future. This could lead to fragmentation of regulatory powers of the Welsh Government over areas of Wales if the number of inset appointees increases. Potential solutions to this issue are currently being explored.

6. The water strategy outcomes and priorities for business customers are best served by retention of the vertical integration of wholesale (or upstream) operations, enabling integrated catchment solutions to be developed.
7. Comparative regulation should continue through Ofwat using data available from England and Wales, with a clear remit from the Welsh Government to compare water bills and customer service for business customer retail, household retail and wholesale elements of each water company. In this way, the relative benefits of competition can be compared and added to the evidence base. The WICS should also be asked to provide similar comparative data for Scotland.
8. The six key policy action areas outlined in Figure 28 should be developed further jointly by Welsh Government in consultation with Ofwat and CCWater, and with support as appropriate from Natural Resources Wales, the Welsh Local Government Association, other relevant NGOs, water companies and appropriate trade and business representatives.

9. The creation of a Wales-only water economic regulator is not recommended given that the vast majority of the water regulatory regime remains common between England and Wales, and therefore the set up and ongoing administrative costs are not justified. The Welsh Government already has powers under the Water Industry Act 1991 (as amended) to provide guidance to Ofwat on social and environmental matters.

10. Ofwat and Defra should confirm that the necessary safeguards will be put in place to ensure set-up and maintenance costs for retail competition in England (and the Anglo-Scottish market arrangements) are not passed on to water companies that operate wholly or mainly in Wales.

11. The potential for water and sewerage legislation to be enforced according to national political boundaries should be explored further, building on the recommendations of the Silk Commission (2014). Amongst other benefits, this would ensure democratic accountability for any concerns raised by business customers as to eligibility for retail competition or other future legislative changes. The timing of any transition should consider the impact on water company retail operational changes that will be needed to reflect the different retail market regimes in Wales and England.

12. The Welsh Government should work with Ofwat, CCWater and the water companies to ensure strong communications and information are made available to business customers about eligibility for retail competition, particularly those customers in cross-border areas, to avoid any confusion.

13. The Ofwat Service Incentive Mechanism (SIM) for business customers supplied by companies wholly or mainly in Wales should be strengthened (compared to the draft published in October 2013) to include comparison with performance of English water companies in relation to business customers. This should include CCWater's compilation of customer

service performance and complaints for all water companies in England and Wales.

Consideration should also be given for the SIM to provide greater incentives (reward) than currently proposed to improve customer service. This should be set within the context of the final Outcome Delivery Incentive proposed by Dŵr Cymru Welsh Water for the next price review period relating to non-household customer service.

14. The Welsh Government's water strategy should include a measure of success related to business customer satisfaction, tested in concert with CCWater market research with business customers in Wales.



## Section 1

### Background and Context

This research project was commissioned by the Welsh Government to explore opinions and views on the future provision of water and sewerage services in Wales in relation to commercial (non-household) water customers.

Cascade Consulting and ICS Consulting have carried out independent research to assess the future needs of commercial water customers in Wales. The research has also evaluated a range of alternative scenarios for the future management of water and sewerage provision to understand how these needs could be met whilst also achieving the social, environmental and economic outcomes sought by the Welsh Government.

#### 1.1 Background to the research project

A wide range of legislative and policy developments have been taking place in recent years at the EU, UK and Welsh scale relating to the management of water and the natural environment. At the core of these developments has been a recognition of the need to respond to future challenges of sustainable development and potential climate change. This has led to exploration of alternative options for managing the natural environment, including management of the water environment and the sustainable provision of water and sewerage services.

The principle of sustainable development is embodied within the constitution of Wales and lies at the heart of the Welsh Government's natural resources management approach that has been promoted under the 'Living Wales' programme since 2010.

As part of this approach, the Welsh Government is developing its water strategy to ensure that water is managed sustainably to achieve good outcomes for the environment, people, businesses and the economy of Wales. This water strategy is being developed against the backdrop of

ongoing reform of the public water supply and sewerage regime in England and Wales. This includes changes being introduced by Ofwat to the regulation of water and sewerage companies and market reform proposals originally set out in the draft Water Bill (2012) and now contained in the Water Bill (2013) currently progressing through the UK parliament.

The Water Bill provides the Welsh Government with the opportunity to develop the market reform agenda for public water and sewerage services in Wales in a different manner to that being proposed in England. Under the Water Bill, the Welsh Government has decided not to implement wider competition for water and sewerage companies operating wholly or mainly in Wales. The government is not currently convinced that this will deliver any measurable benefits for Wales. The government is exploring mechanisms that will drive innovation and improvements in the water industry to achieve the best outcomes for Wales. The Welsh Government has taken a power in the Water Bill to implement further competition in the future if evidence suggests that it will provide benefits for customers, the economy and environment of Wales.

The strategic direction for future regulatory approaches in Wales will be set out in the Water Strategy being developed and consulted upon by the Welsh Government.

#### 1.2 Aims and objectives of the research

This research project has been commissioned to contribute to the evidence base for the Water Strategy in relation to the future proposals for managing public water and sewerage service provision in Wales. It aims to provide policy options for most effectively meeting the future needs of commercial (non-household) customers in Wales whilst also achieving the wider outcomes for natural resources management in Wales.

## Box 1. Research Objectives

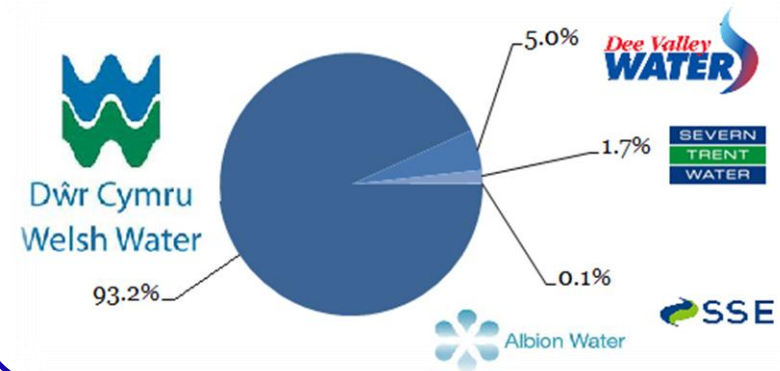
- ❑ Understand the needs of commercial customers supplied by water and sewerage companies operating wholly or partly in Wales
- ❑ Assess and evaluate potential policy options for achieving the needs of commercial customers
- ❑ Assess and evaluate potential policy options in relation to achievement of the Welsh Government’s outcomes for natural resources management in Wales

### 1.3 Brief overview of public water and sewerage provision in Wales

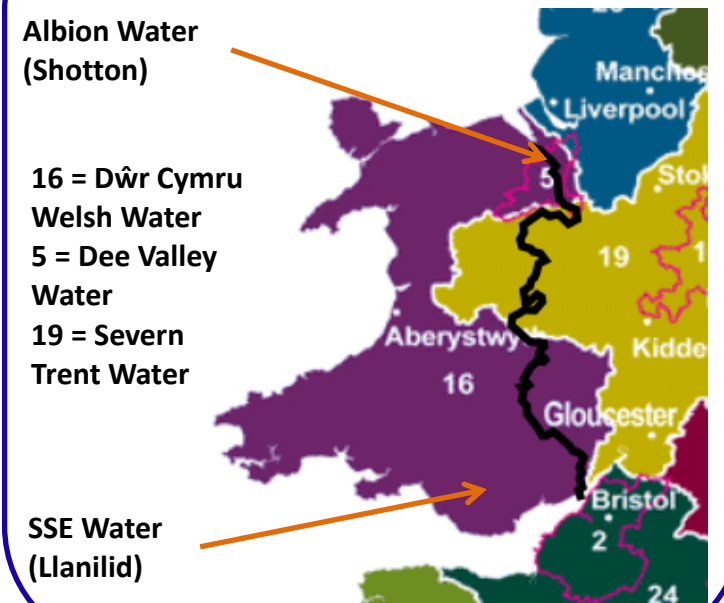
Public water and sewerage provision in Wales has remained broadly unchanged since privatisation of the water industry in 1989. Following the merger of Wrexham Water with Chester Waterworks Company to form Dee Valley Water in 1997, there have been three “incumbent” water companies operating in Wales (Map 1), with Dŵr Cymru Welsh Water the dominant supplier (Figure 1). However, there are also two “inset” appointees in Wales (Map 1) providing water services to Shotton Paper (Albion Water) and Llanilid Park (SSE Water).

As Map 1 shows, Dŵr Cymru Welsh Water and Dee Valley Water provide water to customers in England as well as Wales. Similarly, Severn Trent Water predominately provides water and sewerage services in England, but also serves customers in parts of mid-Wales. These cross-border arrangements need to be recognised in relation to the emerging differences in the competition regimes that apply to customers of incumbent water companies that are “wholly or mainly” in Wales (Dee Valley Water and Dŵr Cymru Welsh Water) and subject to Welsh legislation, and customers of those incumbent companies that are “wholly or mainly” in England (i.e. Severn Trent Water) and subject to English legislation.

Figure 1. Public water supply provision in Wales



Map 1. Public water supply companies operating in Wales



Source: Water UK

## 1.4 Legislative and regulatory background

There is a significant body of legislation and regulations governing public water and sewerage provision in Wales. This includes EU, UK and Wales-specific legislation. Equally, a range of regulatory bodies exist to enforce this legislative and regulatory framework (Figure 2).

In relation to this research project, the role of Ofwat as the economic regulator for England and Wales is particularly important. The Water Industry Act 1991 (as amended by more recent legislation) provides the principal legislative framework for the governance of water companies (including inset appointees) and the economic regulatory powers of Ofwat.

The Consumer Council for Water (CCWater) is a statutory body established to represent the interests of consumers in the water industry. A regional committee for Wales exists to represent the interests of water consumers in Wales.

The water regulatory regime has continued to evolve since privatisation, including measures to increase the level of competition for large commercial water users. The scale of reform has accelerated in recent years, with Ofwat introducing changes to the economic regulation regime and proposals included in the Water Bill to provide governments in England and Wales with powers to increase competition for both retail and wholesale activities.

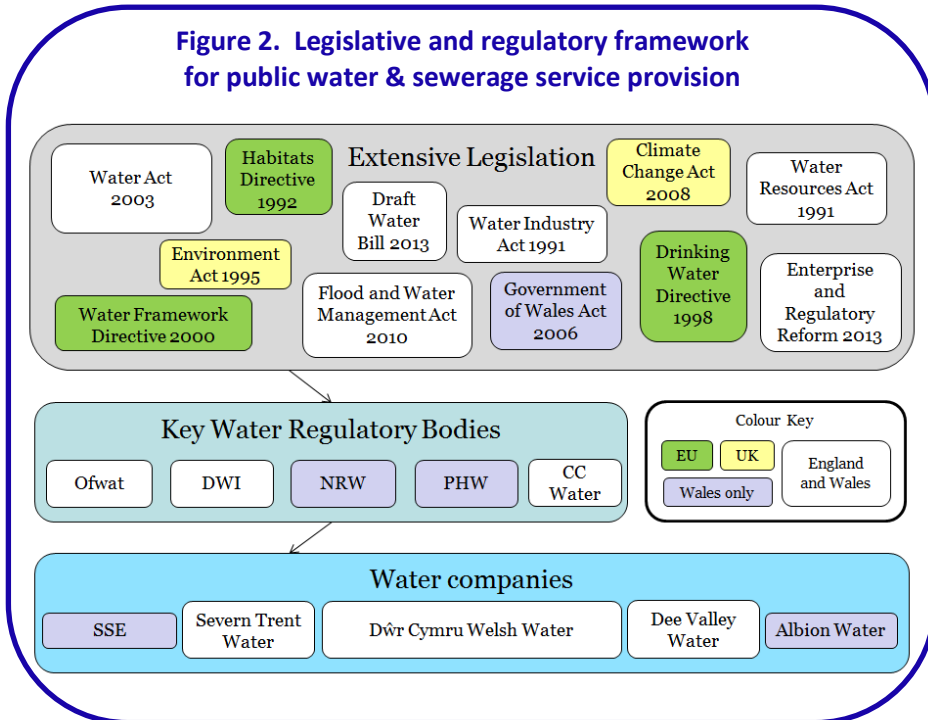
These recent developments in regulatory and market reform are the most significant changes to the water industry to be considered in Wales since privatisation.

## 1.5 Natural resources management in Wales

Alongside proposed changes to the water industry, the Welsh Government has been developing and implementing its policies and strategies for natural resources management in Wales (Box 2). Aiming to ensure sustainable development in Wales, the Welsh Government introduced the 'Living Wales' programme in 2010 to deliver improvements in the management of natural resources in Wales.

This programme has included the formation of Natural Resources Wales (NRW) in April 2013 to bring together the principal regulatory bodies with responsibility for natural resources management:

**Figure 2. Legislative and regulatory framework for public water & sewerage service provision**



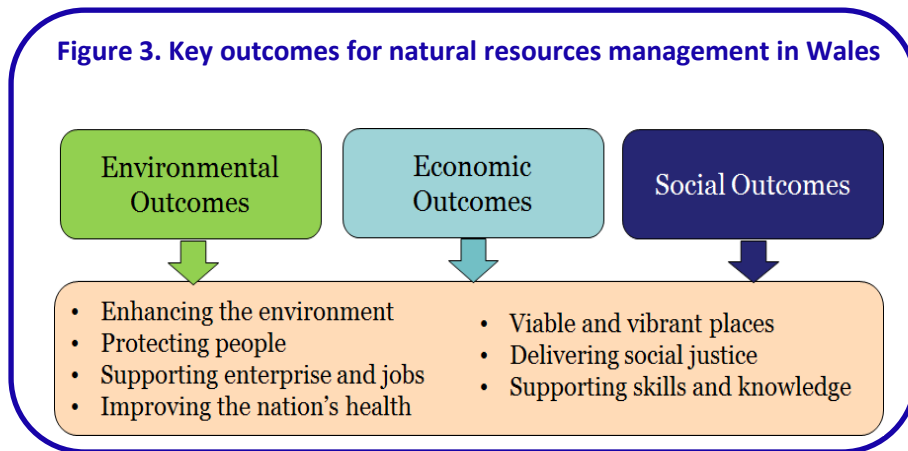
The legislative powers of the National Assembly for Wales are limited to the appointment and operation of Dŵr Cymru Welsh Water and Dee Valley Water – whose areas are wholly or mainly in Wales. Legislative issues relating to Severn Trent Water (despite part of its operations being within Wales), are a matter for the UK Government.

- Countryside Council for Wales
- Environment Agency Wales
- Forestry Commission Wales.

NRW and the Welsh Government have shared objectives and outcomes for natural resources management in Wales (Figure 3).

In 2012, the Welsh Government’s consultation on the ‘Sustaining a Living Wales’ Green Paper showed broad support for a fresh approach to the planning and management of natural resources in Wales. This was further developed into the 2013 Environment (Wales) Bill White Paper setting out the legislative proposals for integrated natural resource management in Wales.

**Figure 3. Key outcomes for natural resources management in Wales**



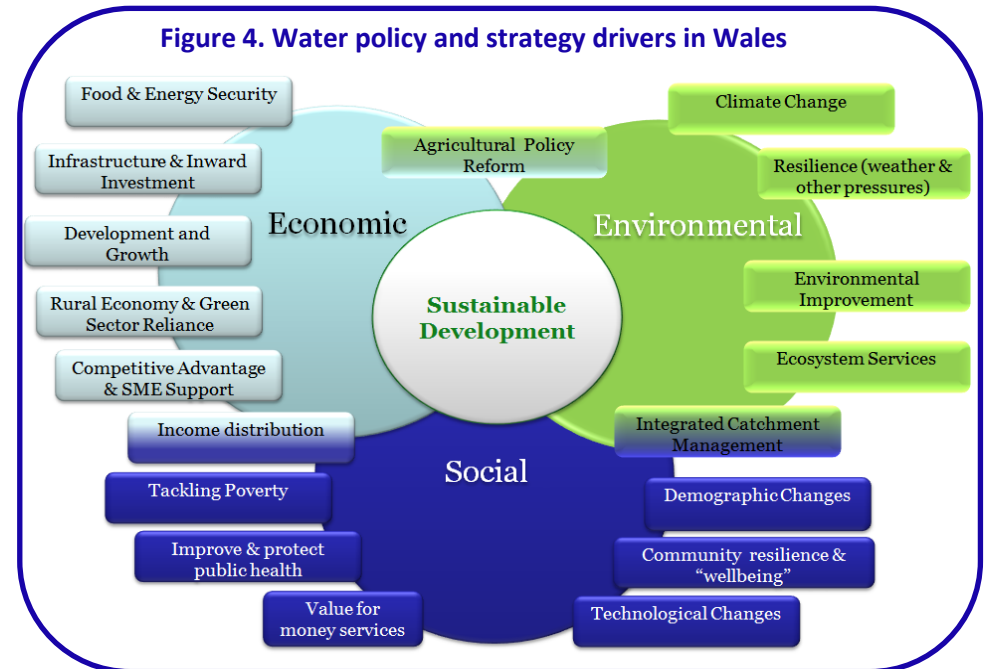
## 1.6 Water Strategy for Wales

Development of a water strategy for Wales is an important component of delivering the key outcomes for natural resources management set out by the Welsh Government (Figure 3). The water strategy currently being developed by the Welsh Government therefore aims to address the future environmental, social and economic challenges for managing

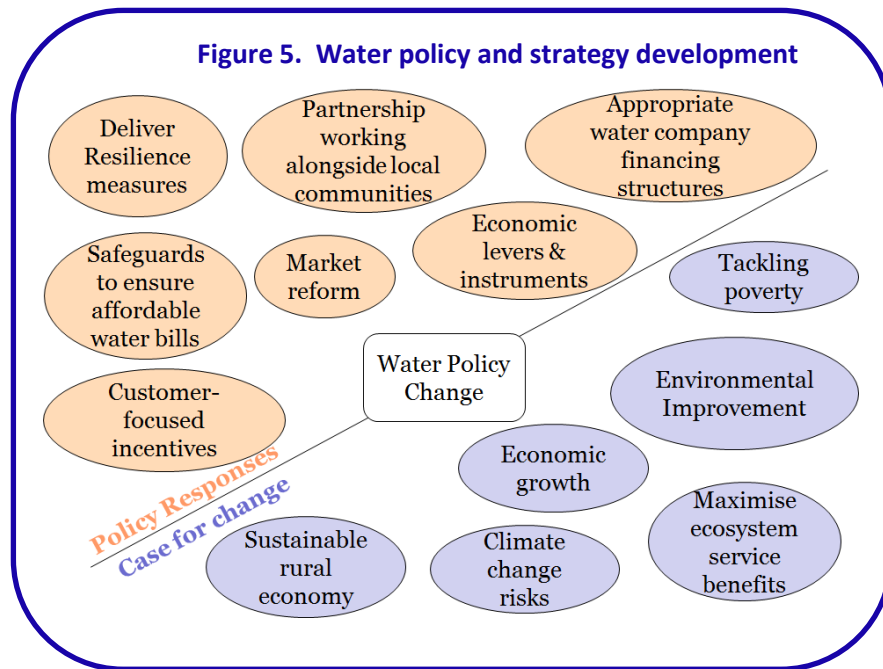
water within Wales (Figures 4 and 5) and seeking integrated solutions to achieve the desired outcomes.

Assessment of the contribution of market reform and water competition to achieving the government’s outcomes is part of the development of the water strategy. The integrated, outcomes-based approach provides a framework for assessing the future needs of commercial water customers in Wales and assessing policy options for their achievement. The assessment therefore needs to take account of environmental, social and economic impacts or benefits in Wales.

**Figure 4. Water policy and strategy drivers in Wales**



**Figure 5. Water policy and strategy development**



**Box 2. Key Water Bill changes for water and sewerage provision**

- enabling all business customers in England to switch their water and sewerage supplier
- establishing cross-border retail arrangements with Scotland for business customers
- enabling businesses to provide new sources of water or sewerage treatment services
- making it easier for water companies to buy and sell water from each other
- enabling owners of small-scale water storage to sell excess water into the public supply
- enabling developers or new water/sewerage companies to more easily connect new developments to public water and sewerage networks
- providing Ofwat a new over-arching duty to take greater account of long-term resilience

## 1.7 Water market reform landscape and horizons

As outlined in Section 1.1, the Water Bill currently before the UK parliament would provide powers for governments to introduce some significant changes to the water regulatory regime (Box 2). Under the provisions of this Bill, competition requirements for water companies operating wholly or mainly in Wales will remain a matter for the National Assembly for Wales. The Welsh Government has decided not to introduce the Water Bill measures enabling wider retail and wholesale competition at this stage. However, it will have the powers to introduce such changes at a later date. The Welsh Government will decide the extent of any changes to be introduced in Wales following further review of the evidence base and assessment of the benefits to Wales.

The threshold water consumption volume for most business customers in Wales to switch their water supplier will therefore **remain at 50 million litres per year** for customers of water companies wholly or mainly in Wales. However, if the Bill is enacted, the option to change water and sewerage suppliers **would** be available to businesses in the Severn Trent Water area of Wales, but not to those in England served by Dee Valley Water or Dŵr Cymru Welsh Water. No customers of Dee Valley Water or Dŵr Cymru Welsh Water will be able to switch their sewerage supplier irrespective of the volume of water they consume. Competition in the form of the **inset appointment regime will continue** for water and sewerage services in all parts of Wales.

The Welsh Government is committed to sustainable management of water resources in Wales. It is therefore considering the need for any

changes to the water abstraction management regime in Wales as part of the future water strategy. This research project focuses on the future needs of business customers and the policy options to meet these needs. The findings will support the Welsh Government in developing its water strategy.

## Section 2

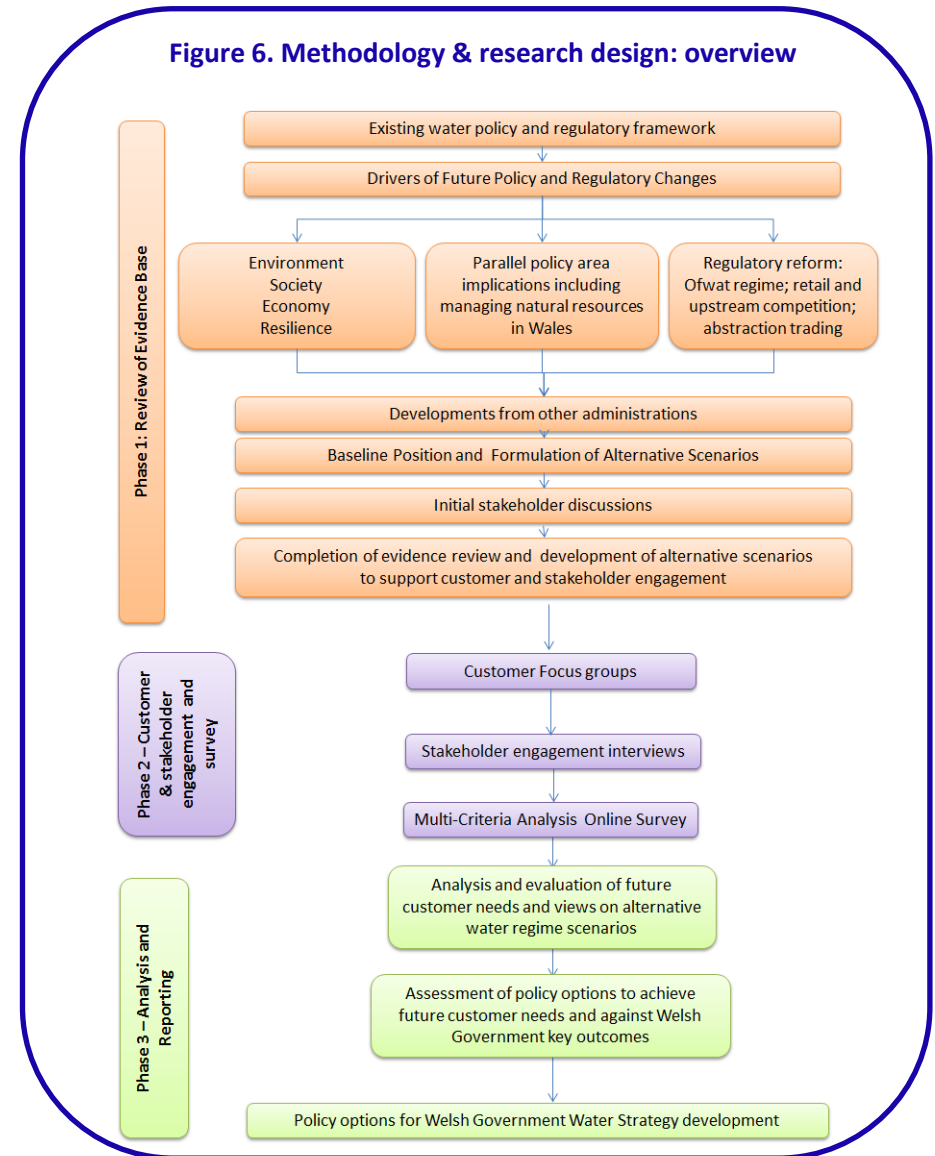
### Methodology and Research Design

The methodology and research design for this project is summarised in Figure 6.

A review of the existing evidence base in relation to water regulation and competition, water policy and drivers for change, along with evidence from other utilities and initial stakeholder discussions, framed the development of potential future alternative policy scenarios for evaluation and testing (Phase 1).

Assessment of these scenarios against Welsh Government objectives and outcomes was informed by the review of the evidence base together with consultation with a range of stakeholders. As well as qualitative feedback from stakeholders, quantitative evaluation of the scenarios and Welsh Government outcomes was carried out through customer workshop activities and Multi-Criteria Analysis (MCA) using a structured, on-line MCA survey issued to 1,000 business customers in Wales (Phase 2). Further details are provided in Appendices A and B.

The findings from Phase 1 and Phase 2 informed the assessment of future business customer needs and the potential of the alternative policy scenarios to meet those needs. The alternative scenarios were also assessed against the Welsh Government objective and outcomes. From these assessments, a set of policy options have been proposed to support the development of the Welsh Government water strategy.



## Section 3

### Review of Existing Evidence Base

#### 3.1 Scope

A detailed review of the existing evidence base has been carried out, focusing on how business customers are served by:

- The existing and proposed water and sewerage regulatory regime and market in Wales
- Existing and proposed water and sewerage regulatory regimes and markets in other nation states
- Regulatory regimes and market operation in other utility sectors

The findings are summarised below with further information provided in Appendix C.

#### 3.2. Water and sewerage regulatory changes

As described in Section 1, there are a wide variety of future challenges that drive the need for a water strategy for Wales – from European legislation to the national drivers to deliver sustainable development, integrating economic, social and environmental improvements to benefit customers and the people of Wales. Through the Living Wales programme and the Environment (Wales) Bill a clear set of outcomes have been established. Changes to the management of water within Wales are required to achieve these outcomes, taking a more integrated, aligned approach across all those who regulate or provide water and sewerage services.

#### *Ofwat regulatory regime*

At the same time, Ofwat has introduced some significant changes to the regulation of water companies in England and Wales (Box 3). Ofwat considers that these changes will provide a much greater focus on the needs and requirements of customers (both household and commercial). There will be specific retail regulation for business customers in Wales,

comprising a non-household retail “price-cap” subject to efficiency challenges and a targeted customer service incentive mechanism in the absence of full retail competition. Effects of the new regime are considered to be overall positive in relation to the Welsh Government outcomes.

#### Box 3. Key changes to Ofwat regulatory regime

##### *England and Wales:*

- Customer and environmental outcomes rather than outputs approach to company targets
- Total expenditure incentive regime, encouraging operational solutions such as catchment approaches rather than engineering solutions
- New incentives for water trading, sustainable abstraction management and resilient networks
- Enhanced retail customer service incentive mechanism for household customers
- Separate price control mechanisms for retail and wholesale services

##### *Wales Only:*

- New retail customer service and efficiency incentive regime for business customers

#### *Water Bill*

Ofwat will have wide discretion on the detailed aspects of implementation of codes and practices for market reform. Uncertainties exist as to the precise details of these reforms and therefore potential costs and benefits are also uncertain. Guidance to Ofwat or amendments on Codes and Practices relating to licences, charging and bulk supply contracts, will require agreement between the Secretary of State and the Welsh Assembly.



Potential conflicts may arise between achieving environmental objectives and the introduction of upstream competition in the UK, which may hinder partnership working and collaborative approaches to managing the environment. Conversely, competition may encourage a greater number of parties to become involved in natural resources management in water catchments, and provide greater opportunities for market-based instruments and payments for ecosystem services.

The evidence base for upstream competition needs to be expanded to strengthen initial assessments of the potential costs and benefits. This includes evidence in relation to potential environmental or technical/engineering risks arising from changes to network and treatment configurations. These risks include reduced resilience as well as disaggregation of responsibilities for public health and environmental protection.

### **Border Issues**

The Water Bill does not address non-aligned boundaries between regulatory, legislative and environmental policies. It continues to delineate on the basis of the water company service boundaries. Sewerage remains subject to the legislative powers of the UK Parliament and has not been devolved to the Welsh National Assembly. There is consequently the potential for complaints from business customers in cross-border areas (see Map 1) that they are subject to national legislation for many of their activities (including environmental legislation), but for water and sewerage services they are bound by the legislation of another nation state as determined by their water supplier rather than their geographical location.

### **“Silk Commission” review**

The Commission for Devolution in Wales (the “Silk Commission”) has recently (March 2014) published its report on devolved legislative powers in Wales, including a review of the implications of the Water Bill. The Commission concluded that *“the administrative boundary should define*

*the limit of Welsh Government competence”* and that *“there is a strong case for powers relating to sewerage to be devolved”*.

### **3.3 Synthesis of other key evidence on water market reform for Wales**

#### ***Cave Review 2009 - Review of competition and innovation in water markets in Wales and England***

- Recommended introducing competition into the upstream (wholesale) market, as well as encouraging further retail competition in the non-household market
- Recommended legal separation of water company retail and wholesale operations.
- Concluded that the industry across England and Wales could save £2.5 billion over 30 years, primarily as a result of efficiency gains, together with improved service levels.
- Concluded that Welsh business customers would benefit from retail competition – but given the smaller fraction of customers which are large users of water, *“the overall benefits would be lower”*.
- Further, non-monetary benefits would accrue from competition such as increased customer service standards and added value services, such as the provision of water savings advice
- Acknowledged there were some benefits from the Dŵr Cymru Welsh Water business model which could be *“potentially beneficial for other consumers if it were to be adopted elsewhere”*.
- Acknowledged that there are different social, economic and political circumstances in Wales, including widespread public and political support for the Glas Cymru ‘not-for-profit’ model.

## Welsh Government Strategic Position Statement on Water 2011

- Concluded that the case had not been made to support either the separation of the retail and network businesses in the water sector or the benefits of further competition for domestic customers.
- Customers should be at the heart of the delivery of water and sewage services in Wales. Customer focus requires a sound understanding of customer needs and a strong voice for customer representation.
- Innovation is key to a long term sustainable water industry that meets the needs of customers.
- Customers in Wales served by Dŵr Cymru Welsh Water receive benefits including a customer “dividend” driven by the efficiency of the Glas Cymru ‘not for profit’ business model. Considering its success to date, the government believes it should be given time to prove it is able to provide ongoing benefits to customers in the long term and be seriously considered as part of the wider review of competition alongside other approaches in delivering better value for customers.

## Ofwat’s review of the evidence base for retail competition and separation 2011

The report concluded that:

- Assessing the costs and benefits of retail competition is a difficult and complex exercise. This is because of both the forecasting nature of such an exercise and the absence of many directly comparable precedents.
- The Scottish experience provides the most appropriate set of data to be drawn on for any cost-benefit assessment, while making adjustments to reflect differences in England and Wales.
- The Cave Review remains the most appropriate basis for assessing the potential costs and benefits of introducing retail

competition.

- The main areas of risk and uncertainty in assessing the cost benefit analysis include:
  - The benefits or efficiencies resulting from effective competition are lower than anticipated.
  - Implementation and on-going costs are higher than anticipated.
  - Impacts from mis-selling problems that have occurred in the energy sector.
  - Negative impacts on the cost of capital or the wider financing of the sector.
  - Negative impacts on the environment.

## National Assembly for Wales: Environment and Sustainability Committee inquiry into water policy in Wales 2013

The Committee considered evidence from water companies, regulators and heavy users of water in Wales. The Committee’s view was:

- It remained unconvinced of the financial benefits of introducing competition in Wales, balancing the uncertainties of the potential costs of introducing the market regime and the potential savings for customers.
- Given that Dŵr Cymru Welsh Water is run in the interests of customers, and given the risk of increased bills for household customers to balance discounts to business customers, the Committee did not believe that retail competition for business customers would be a positive step for the people of Wales.
- The Committee recommended that a cautious approach is maintained “until stronger evidence becomes available to demonstrate benefits of competition to Welsh customers”.

## 3.4 Water regulatory regime in other nation states

### Scotland

The regulatory regime in Scotland has developed separately from that in England and Wales, with a single, arms-length, wholesale water company (Scottish Water) wholly in public ownership and regulated by an independent Water Industry Commission for Scotland (WICS). However, since 2008, all business customers have been able to choose their water and sewerage supplier.

**Section 3.5 provides more details on the lessons learned from Scotland.**

### Other European Nation States

Competition and choice of supplier for public water and sewerage services by customers is not a feature of other European states; competition is between private suppliers and the contracts/concessions let by municipalities or local governments. **Further details are provided in Appendix C.**

The lack of choice and competition for water and sewerage services for business customers across the EU and Europe is important to acknowledge when considering the policy options for business customers in Wales and the competitiveness of Welsh businesses at the European scale.

### 3.5 Business customer views and requirements in Wales

Existing research into business customer needs and attitudes towards water competition has been undertaken by CCWater, including across Wales:

- *Setting Strategic Direction: Research into competition with Business customers (2007)*
- *Small and Medium Business Customer Views on Competition in the Water and Sewerage Industry (2010)*
- *Understanding the Needs of Small and Medium Enterprise Customers (2012)* – joint study with Ofwat

This body of research indicated general support for competition in the water industry in principle across all sizes of business customers across England and Wales. However, the knowledge and expectations of competition in the water and sewerage industry is currently low.

The research indicated that the main driver behind support for competition and interest in switching suppliers is **cost savings** (Box 4). However, business customers are generally **satisfied with their levels of service** from water and sewerage suppliers and **improved levels of service was not a significant factor**. This existing body of research for business customers in Wales specifically indicates some key differences from the overall conclusions for England and Wales as a whole (Box 5).

CCWater is currently completing a further survey of SMEs in Wales and England to identify any changes in the metrics for value for money and the findings are expected to be reported in late spring 2014. CCWater is also carrying out further research on market reform, including focus groups and interviews with business customers in “cross-border” areas between England and Wales to help track how changes in awareness of market reform over time influence consumer attitudes.

#### Box 4. Motivation for business customers to seek alternative water supplier

- Current cost of water and sewerage bills
- Satisfaction with current supplier service and value for money
- Importance of water and sewerage services to the business and proportional cost (little variation by business size)
- Scale of cost savings offered by switching
- Experience with and attitudes to changing suppliers for other utilities (e.g. energy and telecommunications)

## Box 5. Views on water services from SME businesses based in Wales

- ❑ Overall, a more positive view of service and value for money from water and sewerage companies
- ❑ 61% very satisfied with value for money of water services (compared to 36% in England)
- ❑ 58% very satisfied with value for money of sewerage services (compared to 37% in England)
- ❑ Compared to most English regions, Wales had a greater proportion of businesses supportive of the principle of competition
- ❑ 64% believe competition is a very good thing [compared to 30% in England)
- ❑ Greater proportion interested in switching supplier (42% compared to 32% in England)
- ❑ Would like to see consistent rules for eligibility for competition across the two countries.
- ❑ Less optimistic about the ability for competition to deliver new or improved services.
- ❑ Customers of Dŵr Cymru Welsh Water felt that the Glas Cymru not-for-profit business model meant lower bills and better value for money, which reduced the perceived benefits of competition
- ❑ 38% of Dŵr Cymru Welsh Water SME customers surveyed felt the not-for-profit status made a difference to their views

CCWater has expressed concern that retail competition differences between England and Wales could lead to confusion for business customers in border areas as to their eligibility to change water companies, and **clear communications will be essential**. CcWater will continue to work to ensure that water customers in Wales

who cannot change suppliers are fully informed and continue to receive benefits and improvements and are not disadvantaged (CCWater, 2013). This includes working with Ofwat to ensure that market reform in England does not detrimentally affect business customers in Wales through unintended effects on investor confidence in the industry (affecting the cost of capital), or through the cost burden of market reform shifting onto those customers who cannot switch supplier (CCWater, 2013). CcWater will also continue to encourage companies to innovate and improve their service delivery for business customers.

## Box 6. Key points from water company research on business customer requirements

- ❑ provide tariffs that are value for money
- ❑ better communication
- ❑ resolve problems quickly and ensure customers are kept informed
- ❑ easy for customers to deal and interact with companies
- ❑ single billing for multi-site organisations
- ❑ online billing, meter data and account management
- ❑ better support and improved response times for developers
- ❑ single point of contact and more dedicated customer relationship managers
- ❑ more flexible account and tariff structures
- ❑ added value services such as leak detection, water efficiency advice, trade effluent logging

Ofwat measures customer satisfaction through its **Service Incentive Mechanism (SIM)**. This overall measure does not disaggregate performance between household and business customers. SIM scores for Dŵr Cymru Welsh Water have been slightly above average for the last

two years (2011-2013) whilst those for Dee Valley Water have been slightly below the industry average (Ofwat, 2014c). Findings from recent water company research on business customers are summarised in Box 6 with **further details provided in Appendix C.**

### 3.5 Learning from the Scottish water industry retail experience

With no other retail water markets existing, the Scottish water industry retail experience provides the only available evidence of the costs and benefits of retail competition. The Water Services (Scotland) Act of 2005 created the framework for retail competition for both water and sewerage services. In 2006, the Scottish Water retail business was legally separated into a separate entity known as 'Business Stream' but remaining in public ownership. A Central Market Authority was also created and market 'Operational Codes' developed to support the opening of the retail market in April 2008 (Figure 8) for around 100,000 business customers in Scotland. The market is designed to be as transparent as possible and to minimise transaction costs. The market is therefore built on the basis of regulated, rather than negotiated access, and governed by a set of legally binding market codes.

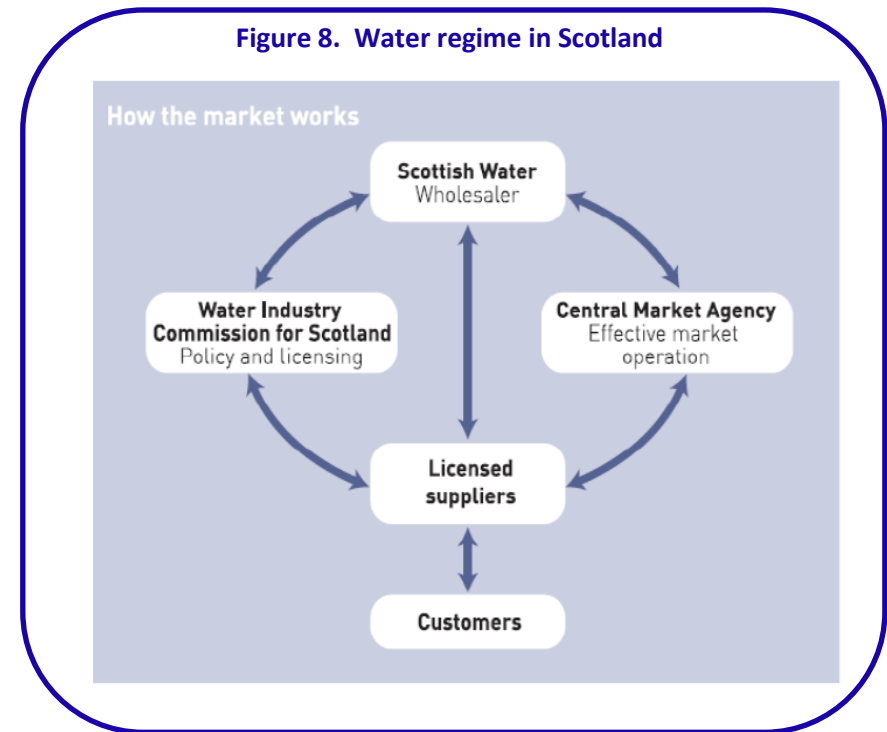
Since 2011, the retail market has seen 13 licensed retailers enter the market. Whilst only 5% of business customers have switched supplier, 50% of the market (approximately 45,000 customers) has renegotiated their water and sewerage services. The market is governed by some key principles (Box 7) to provide consumer safeguards.

#### Costs and benefits

Several reports have been published since the opening up of the Scottish retail market seeking to establish the costs and benefits of retail competition. These reports exhibit a lack of consensus on CBA methodologies, and final estimates, although the general consensus reached is that the market has, thus far, delivered:

- better service, more customer focussed
- efficiency gains in retail costs arising from competitive pressure
- greater water efficiency, leakage reduction and water conservation services for customers

Figure 8. Water regime in Scotland

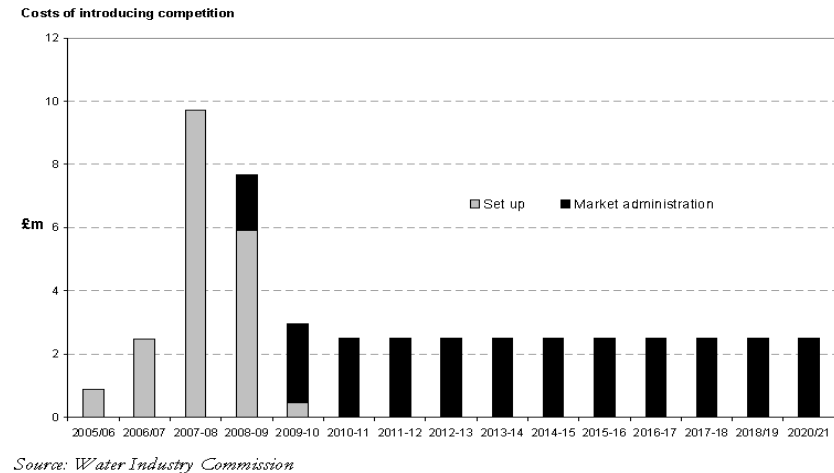


The costs of setting up and operating the market have also been assessed (Figure 9), indicating set-up costs amounted to around £18m – £22m, whilst ongoing costs are averaging £2.5m - £3.5m per annum. Extrapolation by the WICS over a 15 year period (Figure 9) indicates total costs of £45m to £60m.

### Box 7. Key principles of the Scottish water retail market

- ❑ No adverse impact on any customers (commercial or domestic) in terms of price or service standards:
  - “Universal Service Obligation”
  - Default tariffs
  - Default service provision
- ❑ Minimise the risk of ‘cherry-picking’ by new entrants to prevent the ‘unwinding’ of regionally averaged cross subsidies
- ❑ Geographical harmonisation of charges, and non-discrimination of the basis of location
- ❑ Requirement for Scottish Water to publish its wholesale Tariffs to prevent cross-subsidies between the competitive and household markets.

Figure 9. Scottish water retail market costs



Figures 10 and 11 indicate the estimated benefits to non-household retail operating costs relative to costs incurred by water companies in England and Wales. In April 2013, Business Stream provided its analysis of the benefits of retail competition after the first 5 years of operation. Business Stream stated that businesses in Scotland were spending £65million less on water supply than prior to competition being implemented over the five year period, Business Stream calculated that it had had achieved:

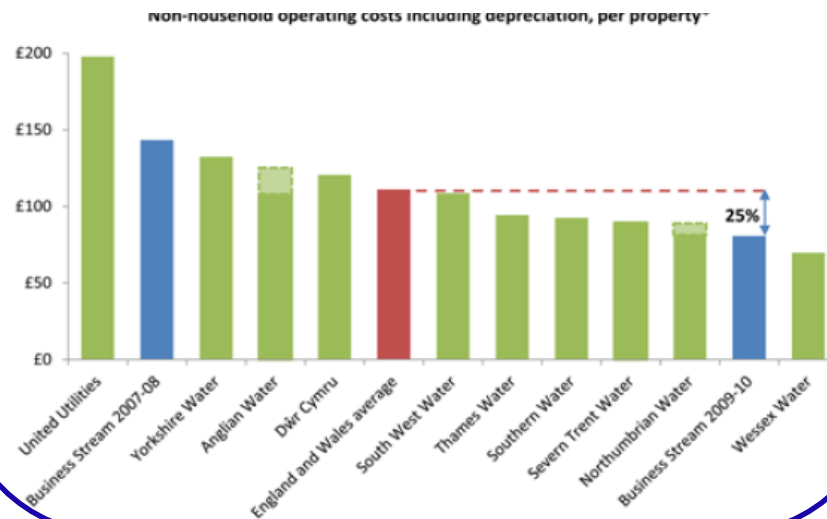
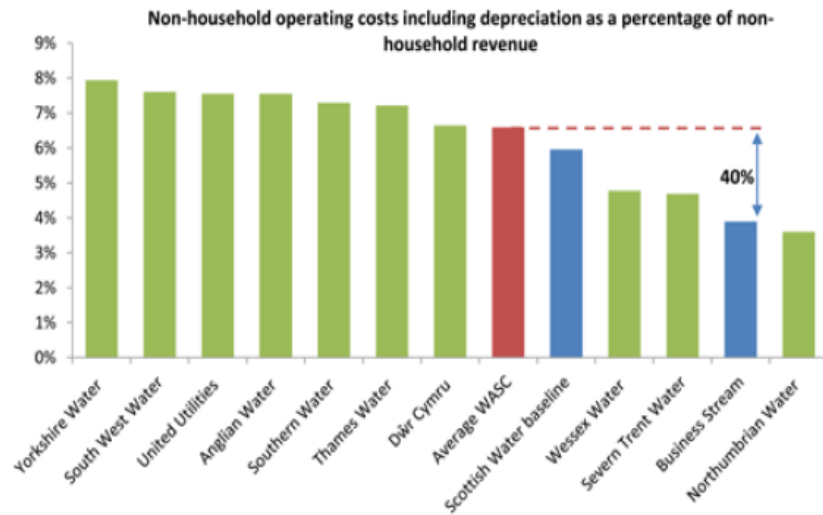
- More than 60 new services to help customers improve water efficiency and cost effectiveness of their water supply
- More than £35 million in customers’ water consumption savings (16 billion litres with associated 28,000 tonnes of carbon savings)
- More than £30 million of discounts provided to customers
- Increase in customer satisfaction by 26 per cent.

The WICS estimates that the net savings to customers in Scotland over the next 30 years from introducing retail competition is £138 million at 2009-10 prices (WICS, 2013 and WICS, 2011).

The Commission states that their analysis takes no account of the savings and efficiency improvements that were achieved by the core business of Scottish Water since 2006 (Scottish Water had already reduced its costs to levels comparable with the water companies in England and Wales by 2006).

Despite a low switching rate, WICS reports that more than 60% of non-household customers in Scotland are now receiving lower prices, better service or a combination of the two in the five years since market opening (WICS, 2013). Some concerns have however been raised that small companies are less able to take advantage of price reductions that relate to discounts for prompt payment terms, for which cash flow constraints preclude take-up by small companies.

**Figure 10 & Figure 11**  
**Business Stream non-household operating costs**  
**as % of non-household revenue and per property**  
 (Source: WICS, 2011a)



Complaints that cannot be resolved between business customers and the vast majority of the retail water companies in Scotland can be escalated to the Scottish Public Services Ombudsman. For the first full year of reporting (2012-13), the Ombudsman reported a general shift in workload from domestic (Scottish Water) to non-domestic service (Business Stream) customers, which “*may reflect the difficult economic climate in which small businesses, in particular, are operating*”. This builds on an observed long-term trend towards business customers from the former consumer body, WaterWatch Scotland. However, it is important to note that this may be explained by the fact that household customers pay for water through council tax collection whereas business customers are charged directly by the retail water company. Some 68% of all water complaints to the Ombudsman in 2012-13 were from business customers, with the majority (66%) relating to billing and charging. A significant proportion of the complaints were from small businesses, with confusion and/or lack of awareness of charging regimes and tariffs cited as a key underlying cause of these complaints. This further emphasises the importance of the need for good communications with business customers.

## Section 4

### Scenario Development

#### 4.1 Scenario Approach

In assessing policy options for Wales in relation to water business customers, and to guide stakeholder discussions, a series of alternative policy scenarios were developed to support the research project. The use of scenarios is a common approach in considering future policy development. They enable the advantages and disadvantages to be explored of the realistic ‘poles’ of alternative measures and compared to the existing (or “baseline”) situation. It is important to note that the scenarios are NOT options from which a “selection” is made, but rather they provide information to aid the development of policy.

#### 4.2 Baseline conditions

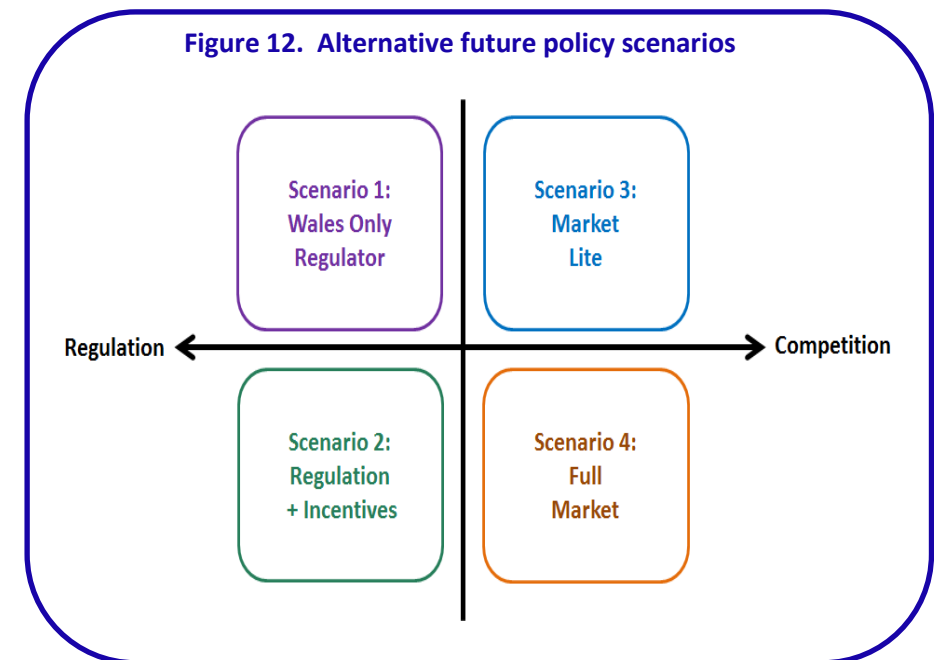
The baseline conditions against which the scenarios are framed and compared are represented by the “current”, existing regulatory regime for water business customers in Wales. This is characterised by the regulated, monopoly privatised water companies operating in Wales, with limited ability for business customers to switch their water supplier and sewerage service provider. Only those business customers consuming greater than 50 million litres of water per year (or 5 million litres per year for business customers located in Wales but supplied by Severn Trent Water) are able to switch their water supplier (but not sewerage provider). In addition, the regulatory regime allows for “inset appointments” (legally known as New Appointments and Variations, or NAV) to be approved by Ofwat to replace the incumbent water company for water and/or sewerage services for business customer sites in Wales consuming greater than 250 million litres of water per year or for new “unserved” developments (household, commercial or mixed occupancy)

that require connection to the water and/or sewerage network. As explained in Section 1, there are currently only two inset appointments operating within Wales (Albion Water at Shotton Paper in north Wales and SSE Water at Llanilid Park in south Wales).

Business customers operating within the England and Wales borders are deemed to be subject to the competition regime of the incumbent water company, regardless of their location within the political boundaries of the two nations.

#### 4.3 Scenario Development

Based on the review of the current legislative and regulatory environment and alternative administrative models (see Section 3), four scenarios were developed to represent a realistic range of potential options for the managing water and sewerage provision within Wales (Figure 12).





Each scenario relates to existing examples in the UK water industry, or to proposals for alternative models to be introduced in the future.

A common set of themes were identified to provide a framework of principles within which the scenarios were characterised. As illustrated in Figure 12, the scenarios were developed along an axis between a highly regulated water and sewerage market and an open, fully competitive market with only modest regulatory oversight.

Boxes 8 to 11 (overleaf) set out the key features of each of the four alternative scenarios. These scenarios have been used to frame stakeholder engagement as discussed in Section 4.4.

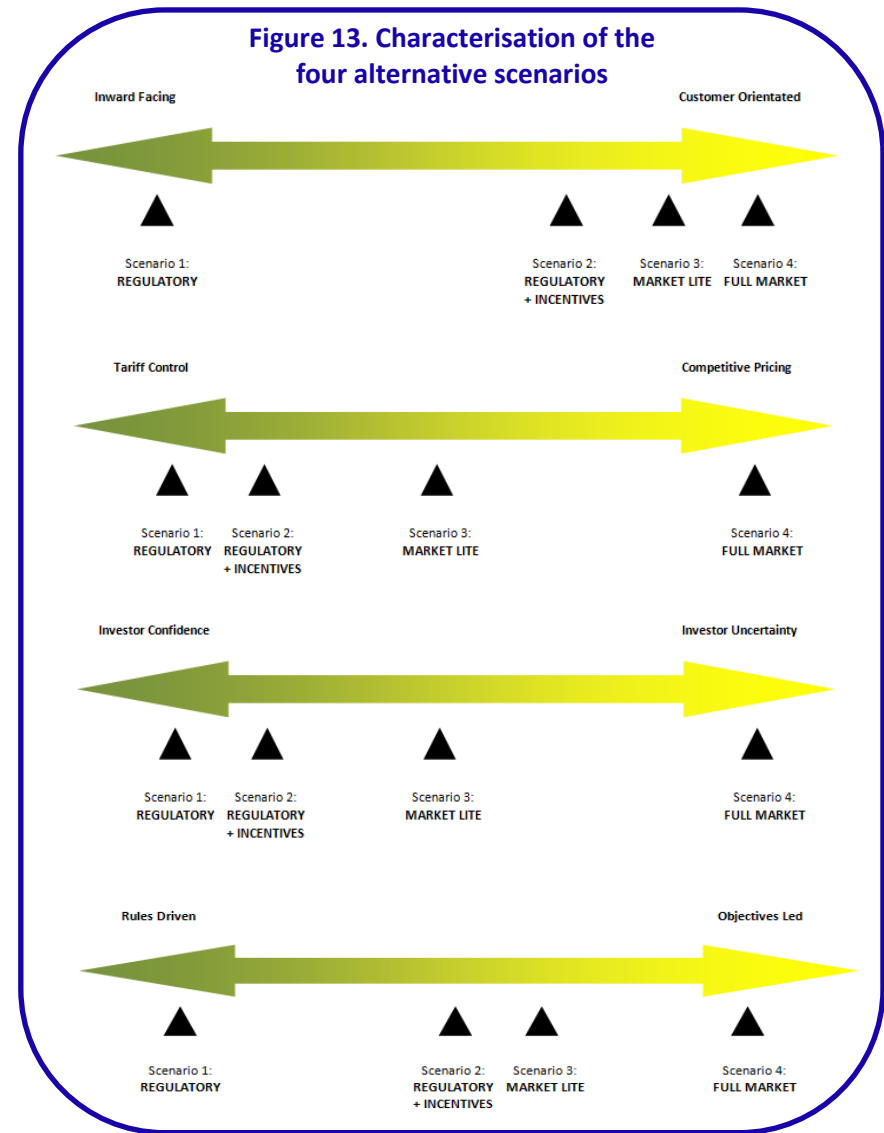
The four scenarios can also be characterised in the relation to some of the key features of privatised utility markets (Figure 13):

### Service responsiveness

- Market models, particularly where the customer can choose to switch suppliers if they are dissatisfied with service, often encourage companies to be more responsive to customer needs
- Heavily regulated businesses can often become focussed on the regulator requirements, rather than the customer needs, and not be responsive to external pressures. This can be addressed by specific regulatory incentives.

### Pricing approach

- Regulatory models have full control over tariff and price setting and can therefore implement redistributive welfare policies through subsidised tariffs
- In markets, competition drives the price levels, and tends to be on a cost reflective basis. In both wholesale and retail markets, this could lead to a 'de-averaging' of prices across the customer base (currently, water and sewerage bills are based on the average costs of supply across the whole of a water company area; 'de-averaging' means applying bills based on the different costs of supply arising in different geographical areas).



## *Investor confidence*

- Regulated sectors are often perceived by investors as providing a greater level of security and certainty, which affects the level
- at which the businesses can borrow capital and, in turn, the customers' bill
- Businesses which are subject to competitive pressures are viewed by investors as more risky, and so the cost of capital is invariably higher.

## **4.4 Research application of the scenarios**

The scenarios have been used to support qualitative discussions and dialogue with stakeholders and business customers. They have also been used to seek quantitative feedback from business customers and non-statutory customer groups through focus group sessions and an on-line Multi-Criteria Analysis survey.

## Box 8.

### Scenario 1: “Wales Only Regulator”

- ❑ Economic regulator established specifically for water and sewerage companies operating wholly or mainly in Wales.
- ❑ Regulatory model similar to other UK “devolved” administrations (Water Industry Commission in Scotland, NIAR in Northern Ireland)
- ❑ Wales-specific regulatory framework evolves from current (2014) regime in place in Wales
- ❑ Legislative powers for sewerage devolved to Wales
- ❑ Extent of competition limited to retail competition for water supply for customers who use more than 50 million litres of water per annum
- ❑ Natural Resources Wales remains as the principal environmental regulator for Wales
- ❑ Inset appointment process continues but with Water Bill changes to streamline the processes

## Box 9.

### Scenario 2: “Regulation + Incentives”

- ❑ Based on the regulatory regime set out by Ofwat to come into effect from 2015
- ❑ Single England and Wales economic regulator (Ofwat)
- ❑ Particular focus on regulatory incentives most relevant to Wales, including:
  - Outcomes incentives (focus on customers and the environment)
  - Total expenditure approach to cost incentives
  - Separate retail and wholesale price controls – including for retail business customers in Wales
  - Welsh Service Incentive Mechanism for business customers who use less than 50 million litres of water per day
- ❑ Inset appointments (NAV) continues but with Water Bill changes to streamline the processes

## Box 10.

### Scenario 3: "Market Lite"

- This scenario is based around the existing Scottish model
- The non-household retail element of water companies wholly or mainly in Wales is legally separated from the wholesale business and subject to open competition (i.e. all business customers can switch retail supplier irrespective of their size).
- Business customer retail competition applies to water and sewerage services
- The wholesale components of water companies wholly or mainly in Wales elements are subject to regulation
- Additional incentives/market instruments or legal powers are developed with water companies to encourage integrated environmental approaches, such as catchment management
- Inset appointments appointment process continues

## Box 11.

### Scenario 4: "Full Market"

- This scenario is based on the current proposals contained in the Water Bill for new entrants to enter into the provision of water and sewerage services at all points in the value chain.
- The scenario has been constructed on the assumption that both wholesale markets and business customer retail markets are fully operational from 2022
- Targeted regulatory incentives will be in place for both wholesale and retail markets
- Household customers will continue to be supplied by the incumbent retailer
- Companies will be driven by competitive market principles, but will still be subject to minimum environmental requirements and statutory obligations
- Inset appointment process continues with barriers to entry addressed

## Section 5

### Stakeholder Engagement and Feedback

The approach to the stakeholder engagement is described in Appendix A. The engagement activities provided a wide range of views and opinions which are summarised in the following sub-sections, with further details provided in Appendix D.

#### 5.1 Stakeholder feedback: key themes

Many of the stakeholders that took part in the interviews or group workshops had previously provided responses and/or evidence to the various White Papers, National Assembly or Parliamentary inquiries, water company price review consultation exercises and other similar consultation exercises. As a consequence, there is a considerable degree of consistency between many of the issues raised by stakeholders from this research and those presented in previous reports and consultation response documents.

The main issues raised by stakeholders can be grouped into a number of key themes (Figure 14).

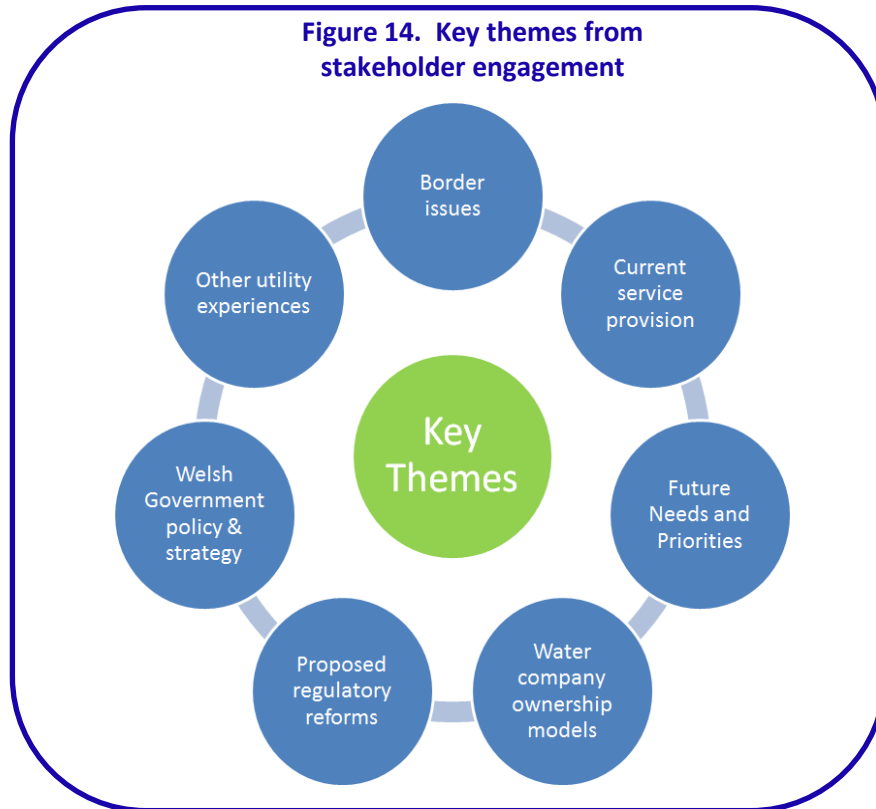
#### 5.2 Current water and sewerage service provision

There is a general consensus across most stakeholders that the evolution of the existing legislation and regulatory regime since privatisation has delivered benefits for customers in terms of key service attributes (Figure 15). In particular, **efficiency improvements and efficient financing** have helped to deliver improved drinking water quality, supply resilience and environmental improvements at an **affordable price for the majority of business customers**. Box 12 summarises the main points raised by stakeholders about current water and sewerage service provision.

#### Box 12. Stakeholder feedback on current service provision

- Water bills remain of lesser concern compared to other cost pressures, particularly business rates and energy bills
- Not enough focus and attention given to business customers
- Greater engagement required to better understand needs and priorities of business customers
- Priority areas for service improvement:
  - Better (and faster) engagement and communication - especially at a technical level on operational matters
  - Greater level of expert advice to customers
  - Improved metering and on-line billing services
  - Speed up the processes for businesses to get connected to the water and sewerage networks
- Greater flexibility and innovation in tariff structures - existing regulatory regime appears to be constraining
- Arrangements for competition for new developments not been as successful as could it could be due to regulatory and behavioural barriers
- Market reform uncertainty and economic downturn limiting commercial viability of further Inset Appointments
- Inset appointment barriers may be limiting innovation in customer and environmental services
- Greater co-operation between organisations responsible for drainage and flooding, including agreeing ownership and responsibilities for maintenance

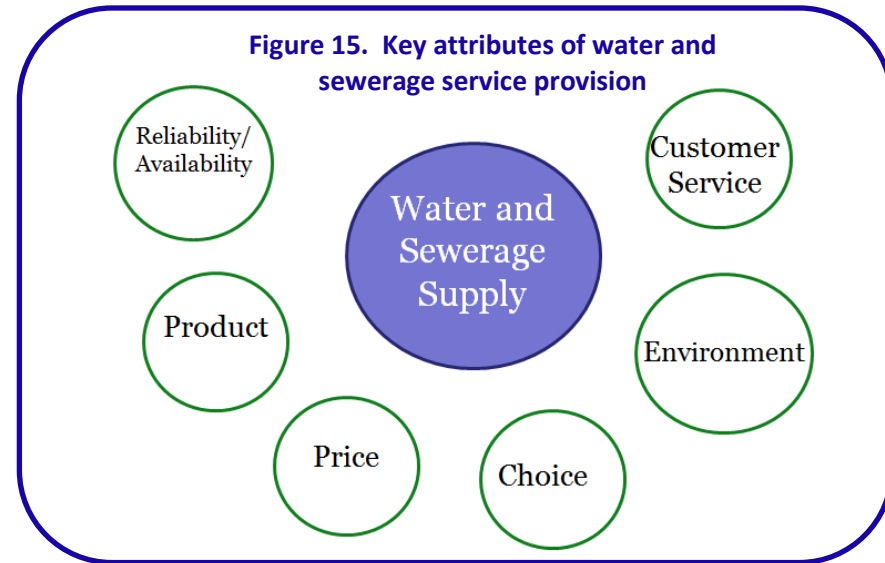
Figure 14. Key themes from stakeholder engagement



### 5.3 Future needs and priorities

Stakeholders expressed a wide range of future needs and priorities in relation to business customers in Wales. Most stakeholders were less concerned with giving view on the future structure of the water industry or changes to the regulatory regime than with ensuring their needs were understood so that government and the water industry can respond effectively to meet these requirements. A summary of the key messages on future needs and priorities is provided in Figure 16 against the key attributes of water and service provision.

Figure 15. Key attributes of water and sewerage service provision



In general, **price and choice were considered of lower importance than reliability/resilience and strong customer service – providing value for money.**

### 5.4 Water company ownership models

There was generally **very strong support for the not-for-profit model of Glas Cymru** (owner of Dŵr Cymru Welsh Water). This extended beyond the financial structure, with a consensus view that the Glas Cymru model also supported **greater community engagement and involvement in wider environmental and social initiatives** than would be the case for a PLC or privately-owned water company. This includes the Glas Cymru independent “Members” that act in lieu of shareholders to provide challenge to the Board, and who are appointed to represent different socio-economic and environmental interests in Wales (although none are currently *specifically* appointed to represent business customer interests). Further views are provided in Appendix D.

Figure 16. Summary of key future needs and priorities for business customers in Wales

## Reliability & Availability

- Improve access to water and sewerage systems for rural communities
- Reduce surface water and sewer flooding and pollution incidents
- Continue resilience improvements and support customers if loss of service

## Product Quality

- Extra services to help customers with leakage and water efficiency
- Embrace sustainable, maintainable drainage solutions with partners
- Focused services for businesses where drinking water quality is critical

## Price

- Transparency on tariff structures and comparability to other suppliers
- Greater flexibility on tariffs to reflect business customer operations
- Tariffs should reward water efficiency and effluent recycling

## Choice

- Choice less important if existing suppliers provide great value for money
- Greater choice and innovation in tariffs would be welcomed
- Ability to negotiate prices and bespoke services would be welcomed

## Environmental

- Partnership working to achieve environmental improvements efficiently
- Work with others to address environmental issues constraining growth
- Innovation to meet future environmental challenges in efficient manner

## Customer service

- Greater engagement with business customers on technical issues
- Metering and billing improvements including on-line bills; sub-metering
- Single point of contact; access to right technical support on first contact

## 5.5 Proposed regulatory reforms

There was a general good level of understanding across stakeholders of regulatory reform measures proposed by Ofwat, contained in the Water Bill or in consultation documents (e.g. on abstraction licence reform). Concern was expressed by some stakeholders that:

- not extending retail competition in Wales may **perpetuate behaviours that act to stifle competition** in those areas that are already open to competition (e.g. new connections and Inset Appointments/NAV's)
- **business customers in Wales will not receive the same price and service benefits** that may arise for customers in England.

Conversely, others expressed the view that **retention of the 50MI threshold in Wales could result in better customer service offerings for non-household customers**.

Some stakeholders felt that the **costs of market set up and management for increased retail competition** in England would cancel out or even outweigh the benefits to customers, recognising the relatively small margins involved and consequent scale of price reduction. **Uncertainties in both costs and benefits** were cited by others as making it difficult to determine whether introducing retail competition would be worthwhile.

Overall, regardless of the differing views on regulatory reform, there was **broad support for the Welsh Government taking powers in the Water Bill that allow Wales to make its own decisions** on the future regulation of water companies operating “wholly or mainly” in Wales. This included support for **legislative powers for sewerage to also be devolved**, which was seen as an anomaly given that it represents around 50% of the total water bill.

Further information is provided in Appendix D.

### Developers

Developers feel they are not valued as customers, that they are not adequately engaged by incumbents to help drive innovation in new

developments, and that there are too many delays and barriers for new connections. Although the number of complaints from developers has reduced in recent times, more still needs to be done to improve levels of service.

### Inset Appointments

There was support from several stakeholders for improvements to the Inset Appointment/NAV process aimed at reducing barriers. **Encouragement for further inset appointments in Wales was viewed by some as an important feature of the regulatory regime** in the absence of wider competition, with benefits cited as including:

- Integrated services for water, sewerage, drainage and energy
- Innovation in new development design, working with developers from the outset, such as sustainable drainage systems, high water efficiency standards, rainwater harvesting and novel sewage treatment solutions
- Added value services for business customers, such as sub-metering, leak detection, water recycling advice, combined energy and water efficiency process improvements.

Conversely, several concerns were raised by some stakeholders in relation to the inset appointment/NAV regime, including:

- Developers are likely to be more focused on reducing cost rather than future customer service.
- Differentially lower costs exist for maintaining new infrastructure within an inset new development (and hence enabling higher margins for the NAV). If there are more insets, the incumbent will have an increased proportion of ageing infrastructure to maintain, leading to upward pressure on bills for customers of the incumbent (effectively subsidising the inset appointment).
- Risk that appointees will walk away once the assets start to deteriorate and require maintenance investment.



Concerns have been raised about the current regulation of inset companies which requires clarifying. For example, an inset company may be granted a licence in Wales and therefore be regulated by the Welsh Government, but if it expands in England, and becomes mainly an English company, clarity is required as to whether it should be regulated by the UK Government, or continue to be regulated by the Welsh Government in respect of all its sites, or whether the UK Government should regulate it in respect of its English sites, and the Welsh Government in respect of its Welsh sites. This would provide certainty, and prevent inset companies from switching from being regulated by one country to another as they expand, and remove the potential effect of fragmenting Welsh Government regulatory powers over areas of Wales if the number of inset appointees increases.

Further stakeholder views are provided in Appendix D.

## 5.6 Welsh Government policy and strategy

Most stakeholders welcomed the overall policy direction of the Welsh Government for natural resources management in Wales, and the integration of environmental, social and economic considerations. Most stakeholders also agreed that Wales should have its own water strategy that focuses on the specific needs and challenges for water and sewerage provision in Wales.

Several stakeholders raised the possibility that **an independent economic regulatory approach for Wales could be considered**, particularly given the widening divergence in adopted legislation between England and Wales. A number of stakeholders felt this **might be further extended to a joint water and energy economic regulator for Wales** in line with the Northern Ireland model. This concept was tested with stakeholders further as part of the four alternative policy scenarios (see Section 6). However, others questioned the costs of setting up and running a separate economic regulator and felt that Ofwat was more than capable of regulating two different retail markets. Although there are differences

in relation to competition, the **vast majority of the regulatory regime remains common to both Wales and England.**

In developing the water strategy for Wales, many stakeholders felt that it was **important to ensure that business customers operating in rural communities were better supported and not disadvantaged** by any changes to the regulatory regime. Access to the public water and sewerage network was cited by several stakeholders as an important element in sustainable growth of the rural economy.

Further details are provided in Appendix D.

### Welsh Government outcomes

Business customers were broadly supportive of the Welsh Government's outcomes for natural resources management. Overall, there was greatest support for the following outcomes:

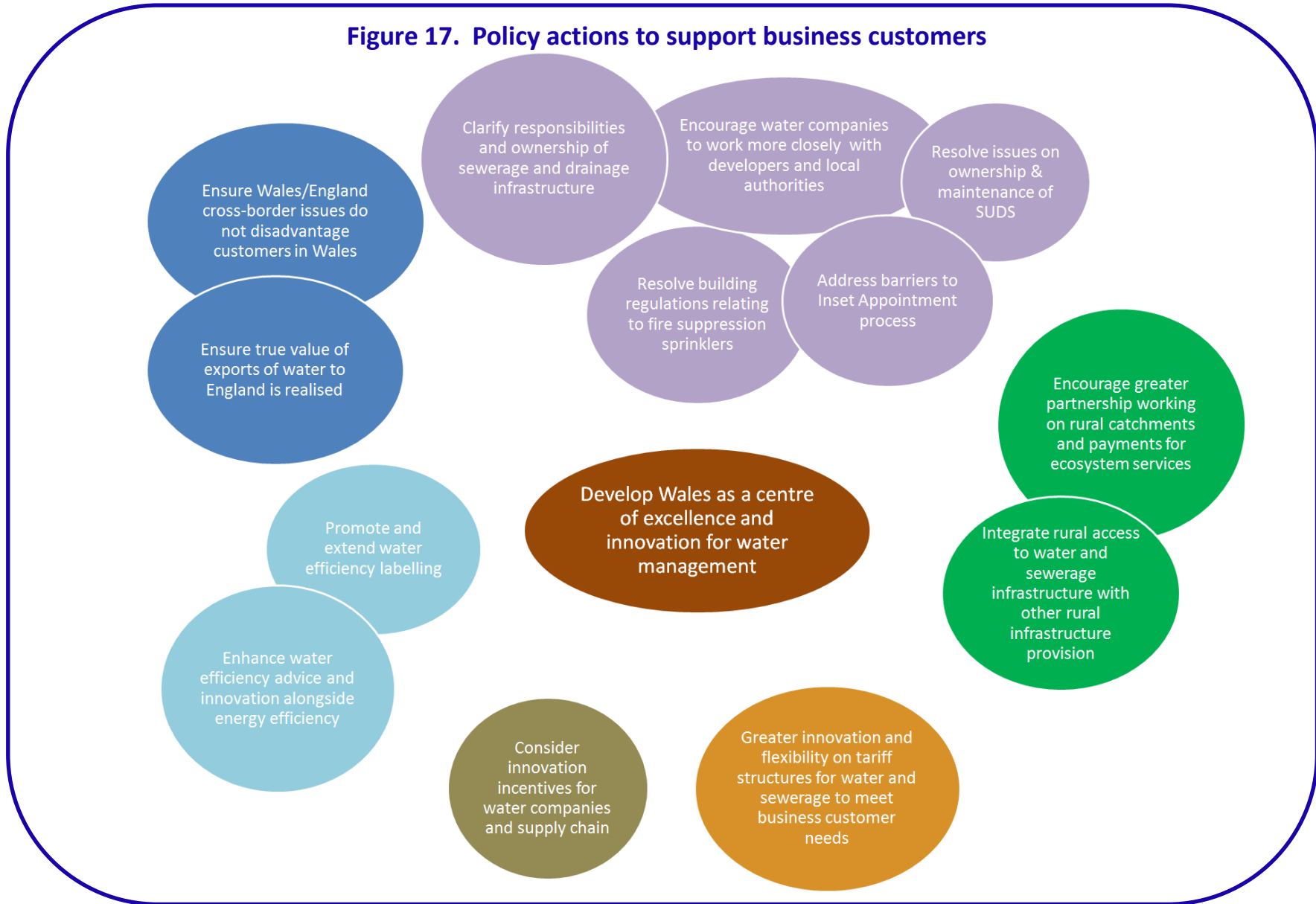
- Enhancing our environment
- Viable and vibrant places
- Protecting people

These three outcomes were considered to particularly **support sustainable economic growth**, which in turn will benefit businesses operating in Wales.

### Policy actions

A number of key policy actions emerged from stakeholder discussions for consideration by Welsh Government that would directly or indirectly benefit business customers, as summarised in Figure 17. The breadth of actions shown in Figure 17 serves to reinforce the message that **business customers' needs and requirements are very broad-ranging** and reflect the economic landscape of Wales. Most stakeholders have commented on the need for the water strategy to **look beyond price and customer service issues** if business customer needs are to be delivered and sustainable growth is to be achieved. Business customers are far from a homogenous group and the strategy needs to recognise that a **"one size fits all" approach is unlikely to achieve the desired outcomes.**

**Figure 17. Policy actions to support business customers**



## 5.7 Wales-England border issues

Most stakeholders referenced the **need for clarity** as to the application of English or Welsh legislation on water competition. There was consensus that **improved information and communication for businesses**, particularly those in “border” areas, is essential so that customers are not confused about eligibility (as has happened in Scotland for small companies – see Section 3.5). Those expressing a preference stated that it would be **preferable for the legislative boundary to follow the political boundary** of Wales

**Changes to the operating boundaries of water companies were considered to be of a much lower priority than other needs and requirements of business customers**, particularly as the greater majority of businesses in Wales are supplied by a water company “wholly or mainly” in Wales and only at one single premises.

**The vast majority of business customers did not consider that having a different retail regime in Wales to England was of particular concern.**

Some stakeholders however were concerned that a “**postcode**” **lottery may arise**, with businesses on one side of the border benefiting from better service or reduced bills, whilst those on the other side were not able to avail themselves of the same benefits.

Additional views are provided in Appendix D.

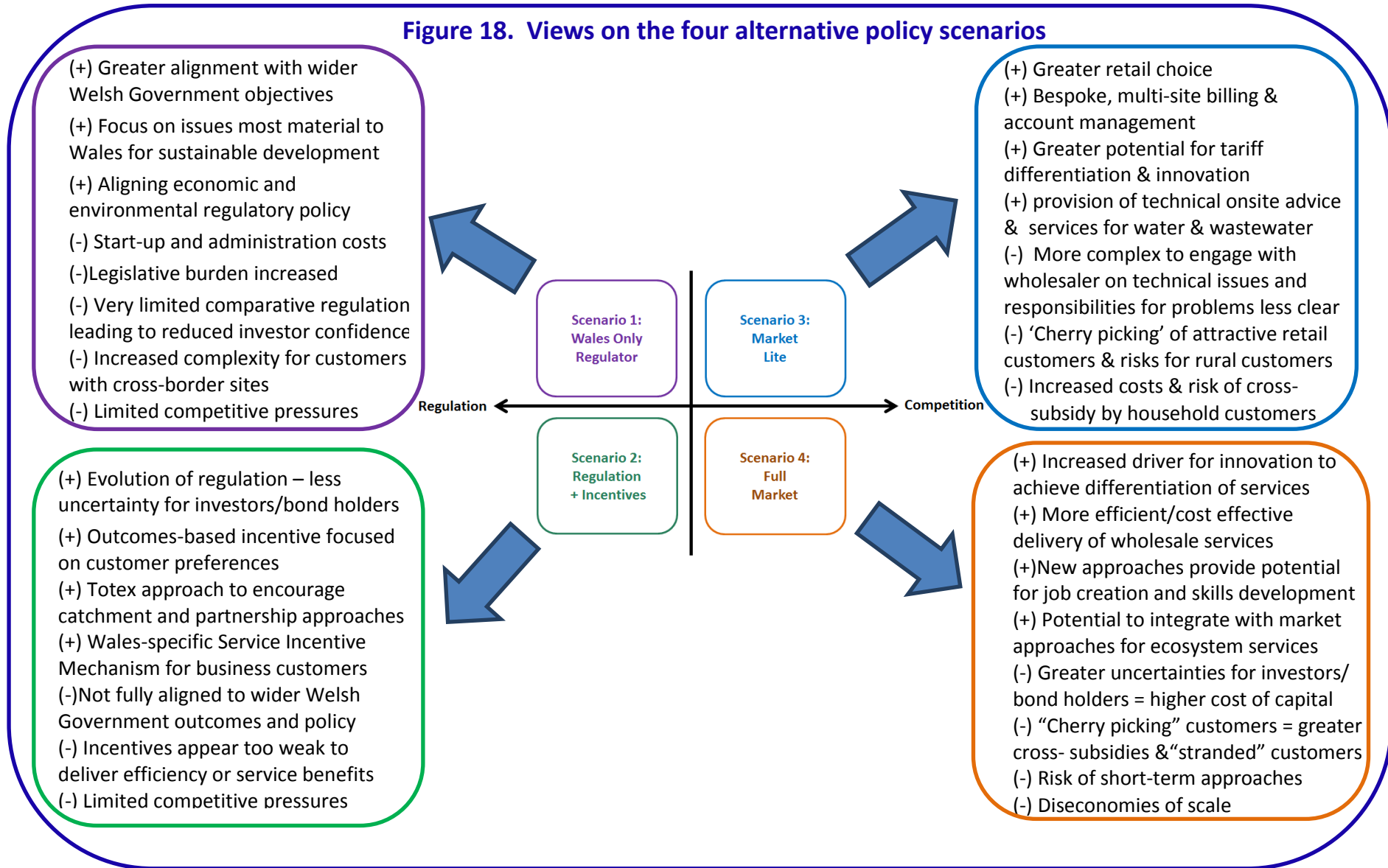
## 5.8 Views on the alternative policy scenarios

Stakeholders were asked to give their view on the alternative policy scenarios described previously in Section 4 as well as through the on-line MCA survey as discussed further in Section 6. Figure 18 (overleaf) summarises the key messages from stakeholders for each scenario.

No clear consensus emerged from stakeholders as to which regulatory scenario would be most appropriate for Wales, with some strong views on either side as to the respective benefits of greater competition versus a continued focus on regulatory measures. Many business customers were less concerned about the “how” than the outcomes to be achieved.

Many felt that the various regulatory options could all deliver for customers as long as the outcomes were clear and companies were incentivised appropriately to achieve them.

Figure 18. Views on the four alternative policy scenarios



## Section 6

### Multi-Criteria Analysis

To inform the stakeholder engagement and evidence gathering, a Multi Criteria Analysis (MCA) approach was adopted to gather quantitative information and enable objective analysis of stakeholder views on the “baseline” and four scenario options. The approach to the MCA survey and structure is set out in Appendix B. This section reports on the results of the survey.

#### 6.1 Multi-Criteria Analysis: survey results

##### Respondents

From the sample of 1000 business customers, 37 responses were received (3.7%). The response rate was lower than the anticipated 5%, but this may reflect the level of previous consultation (as discussed earlier in Section 5, consultation “fatigue” may have affected the response rate) and the relative interest of business customers in water and sewerage provision.

All of the organisations responding to the survey operate in Wales and all but one receives water and/or sewerage services from one of the incumbent undertakers in Wales (Figure 19). The majority are served by Dŵr Cymru Welsh Water, with a small number served by Severn Trent Water and Dee Valley Water. One company is served by a third party on a private water supply network. Respondents represent a wide range of industries (Figure 19), although 39% categorised their business as “other”.

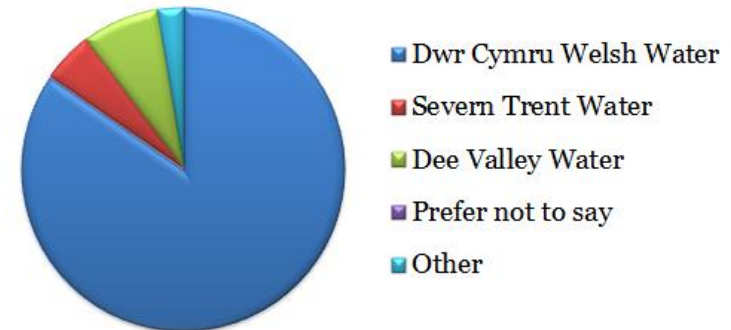
##### Results

A summary of the results are presented in Figures 20 to 24 overleaf. Figure 20 highlights that, in terms of the current business customer experience, product quality (e.g. pressure, drinking water taste) attracted the highest rating, followed by product availability and reliability (e.g.

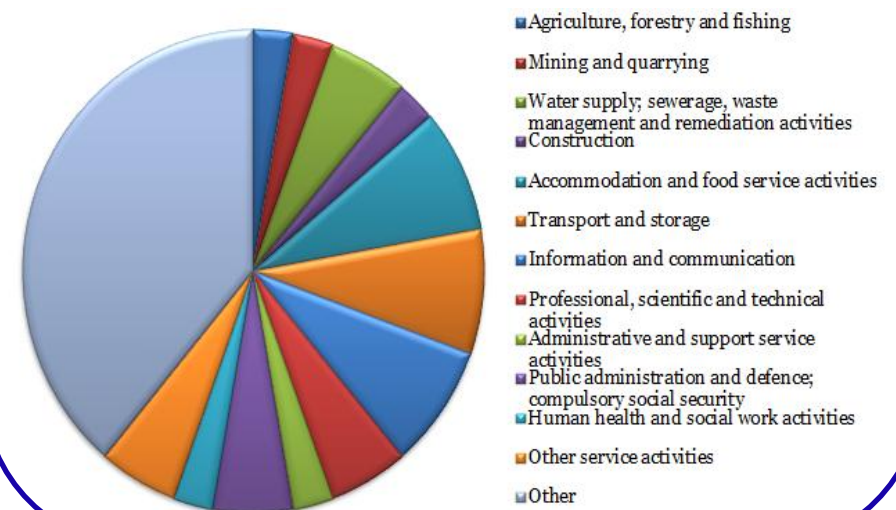
continuity of supply and safe removal of wastewater). Choice of supplier attracted the lowest rating overall, although as indicated in Figure 20, there was a wide range of scores for this attribute as is the case for the other service attributes.

Figure 19. Profile of MCA Survey Respondents

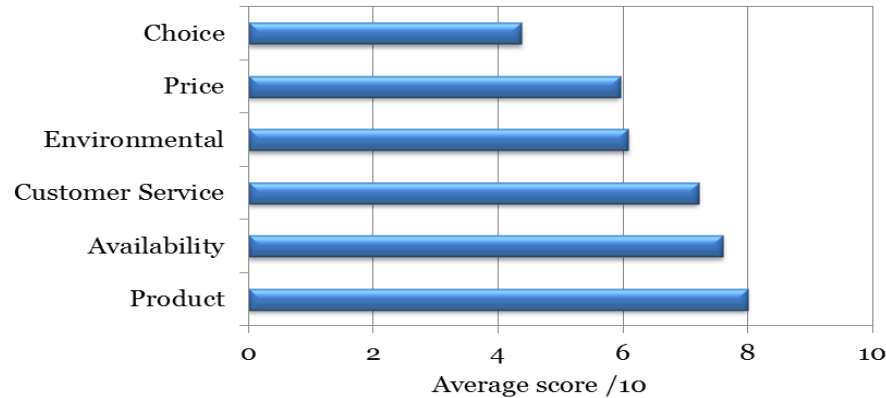
#### a) Breakdown by water company



#### b) Breakdown by Standard Industrial Classification



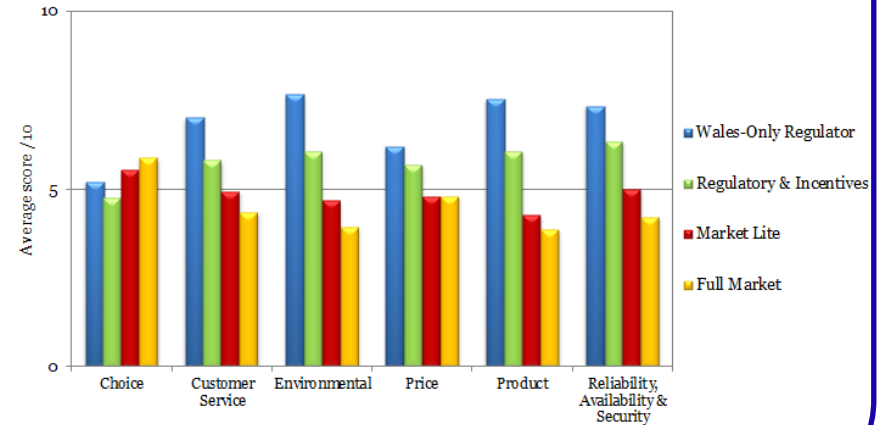
**Figure 20. Views on current water and sewerage service provision**



| Rating  | PRODUCT | PRICE | CUSTOMER SERVICE |
|---------|---------|-------|------------------|
| Average | 8.00    | 5.96  | 7.21             |
| stdev   | 1.9     | 2.0   | 2.0              |
| Maximum | 10.0    | 10.0  | 10.0             |
| Minimum | 5.0     | 3.0   | 3.0              |

| Rating  | CHOICE | ENVIRONMENTAL | AVAILABILITY |
|---------|--------|---------------|--------------|
| Average | 4.38   | 6.09          | 7.61         |
| stdev   | 2.9    | 2.6           | 1.6          |
| Maximum | 10.0   | 10.0          | 10.0         |
| Minimum | 1.0    | 2.0           | 5.0          |

**Figure 21. Views of the effects of alternative scenarios on service provision**



**Ratings: 1 = Poor 10 = Excellent**

Respondents were then presented with the four alternative policy scenarios and asked to rate how they felt each scenario would be likely to affect the different aspects of the water and wastewater service they receive (Figure 21).

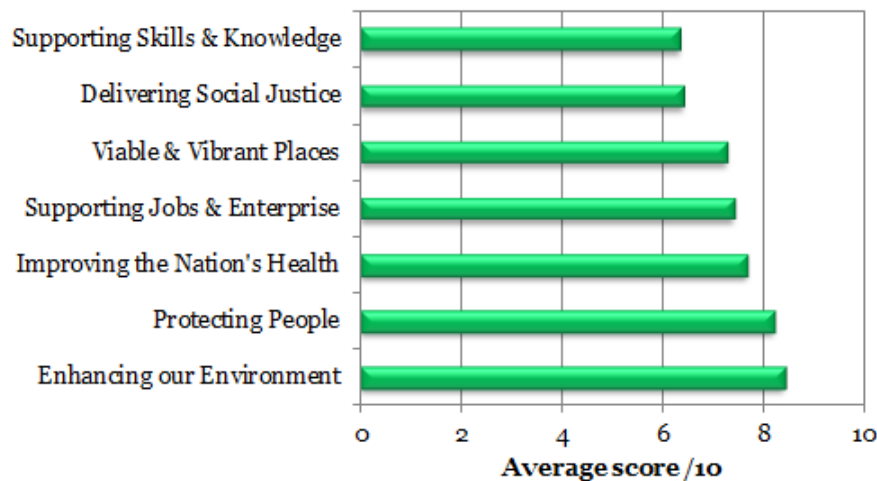
Responses to this set of questions were highly varied, ranging from 1 (poor) to 10 (excellent) for each and every service component. Some respondents clearly felt that the different scenarios would have significant positive and negative effects on service provision whilst others felt it would not make any appreciable difference.

As Figure 21 shows, the “Wales-only” regulator scenario received the highest overall average rating except in relation to choice of supplier. Overall, the ratings for the Wales-only regulator scenario indicate a positive view as to the effect of this policy option across the key

components of service provision, and particularly in terms of environmental aspects. Conversely, the market scenarios (market lite and full market) were viewed overall as to be likely to have a negative impact on most aspects of service, except for choice of supplier.

In considering the Welsh Government outcomes for natural resources management and, more specifically their relevance to water and sewerage provision, respondents were asked to rate their importance and relevance to their organisation (Figure 22). Enhancing the environment and protecting people and were seen as the most important outcomes. Delivering social justice and supporting skills and knowledge were overall seen as being of less importance in relation to water and sewerage provision. The response ratings were less varied than for the earlier questions, with a greater consensus.

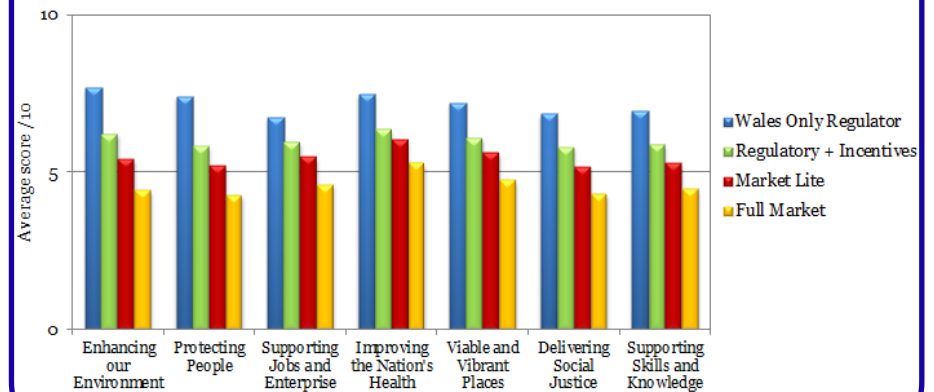
**Figure 22. Views on importance of Welsh Government outcomes in relation to water and sewerage provision**



**Ratings: 1 = Low 10 = High**

Having sought views on these outcomes, respondents were then asked to assess how effective they felt each of the four policy scenarios were likely to be in delivering each of the outcomes in Wales. The responses to these questions (Figure 23) showed similar trends between scenarios for each of the seven outcomes. A Wales-only regulator was viewed as the most positive in terms of delivering outcomes for Wales. Conversely, the full market scenario was the only scenario to be viewed negatively overall in terms of delivering outcomes for Wales.

**Figure 23. Views on how each well each policy scenario will support delivery of the Welsh Government outcomes**



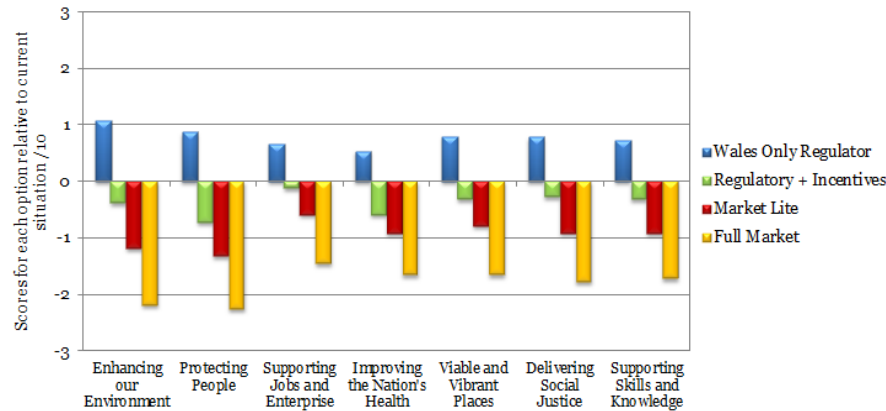
**Ratings: 1 = Poor = Excellent**

Respondents were also asked to rate the ability of the existing regulatory regime (the current “baseline”) to deliver these outcomes. For each outcome, the existing regulatory regime was rated slightly lower than the Wales-only regulator, but consistently higher than for the other three scenarios (Figure 24). The full market scenario was viewed overall as the least effective relative to the baseline. The outcomes that were viewed as

showing the largest changes relative to the baseline were enhancing the environment and protecting people. The outcomes viewed as having the smallest change were supporting jobs and enterprise and improving the nation's health.

These results from the MCA survey have been further assessed and compared to the qualitative feedback from other stakeholder engagement activities as set out below and discussed further in Section 7.

**Figure 24. Ability of the four policy scenarios to deliver the Welsh Government outcomes compared to the current "baseline" regulatory regime**



Difference in rating scores from current baseline regime

## 6.4 Interpretation of results

The results of the MCA survey are based on a small response rate and should be treated with caution as a consequence. The evidence should not be used in isolation, but nevertheless, the key themes emerging from the survey (Figure 25) are broadly consistent with those identified from other stakeholder engagement activities as summarised in Section 5. The

only exception was the stronger support for a Wales Only regulator identified through the MCA survey.

**Figure 25. Linking stakeholder feedback with MCA survey results**

| Priorities & Outcomes   | Policy Options   |
|---|--|
| <ul style="list-style-type: none"> <li>Choice and price of the existing service are rated the lowest in the survey – but stakeholders have indicated that these attributes are lower priorities for business customers</li> <li>Actions to ensure resilience, quality of service and access to public water and sewerage networks emerge as the most important outcomes for business customers</li> </ul> | <ul style="list-style-type: none"> <li>A Wales-only regulator policy scenario was rated as the only scenario that would lead to additional benefits compared to the current baseline.</li> <li>Many stakeholders are broadly supportive of the existing regulatory regime, and consider that targeted improvements, rather than major reform, can address shortfalls against future needs</li> </ul> |

The survey results showed a wide divergence of views at the individual business customer level in relation to the existing service provision and how each of the alternative policy scenarios may affect service provision. This divergence was also evident within different business sectors and



between sectors. No sector showed a strong collective preference for a particular policy scenario. This was also evident from the stakeholder engagement, with experience and issues specific to each customer more likely to influence views.

However, when set against the Welsh Government outcomes that any policy change is seeking to achieve, a greater level of consensus is achieved. The motivation of individual business customers in relation to water and sewerage provision will be different to that of government. In developing the water strategy for Wales, consideration of the outcomes sought by individual business customers will therefore need to be weighed against the outcomes sought for Wales as a nation.

In weighing up the strategic options, the survey results indicate a relatively strong preference for a limited change to the existing regulatory regime to deliver the Welsh Government outcomes (i.e. greatest preference was expressed overall for the Wales-only regulator scenario, which brings greater national control over a modification to the existing regulatory regime).

The results also chime with other stakeholder feedback (see Section 5) that the existing regime is considered to be broadly delivering and that changes should be focused on targeted improvements, rather than more far-reaching reform of the existing regime. At the other end of the policy spectrum, concerns are evident that a full market model would lead to a deterioration in the ability of the water industry to contribute to achieving the Welsh Government outcomes when compared to the existing regulatory regime. This view would appear to accord with the priority weighting given to the Welsh Government outcomes by respondents:

- Enhancing our environment
- Protecting people
- Improving the nation's health

These three outcomes are focused on environmental and social factors rather than economic ones. As a result, it might be the case that the

market option scenarios are rated lower than the other scenarios as market-based approaches are perceived to focus on economic outcomes rather than social and environmental outcomes.

From the weighting of the importance of the Welsh Government outcomes derived from the survey responses and multiplying these by the effectiveness scoring of the potential policy scenarios from the survey responses, the ranking of the benefits can be assessed as shown in Table 2 (higher scores reflect greater overall importance). By weighting the scores according to priorities and effectiveness of policy scenarios, the headline conclusions remain unchanged. The scores also further emphasise that the greatest differentials in benefits between the scenarios and the baseline relate to the two highest ranked outcomes (enhancing our environment and protecting people). However, it is important to reiterate caution in using these results in isolation from other evidence given the small response rate.

### **Summary**

The evidence from the MCA survey has provided further insight into the views of business customers. It has enabled exploration of views of the wider sustainable development aspirations that underpin the Welsh Government outcomes, and an assessment of the relative weighting of outcome priorities. Feedback on the scenarios has been varied, and this needs to be taken into account in considering options for the future. Overall, however, a majority of respondents indicated a preference for adaptation of the existing regime and a relatively strong regulatory framework is considered by respondents to be more effective than a move towards market-oriented approaches.

**Table 2. MCA weighted, ranked scores**  
 (outcome priorities x effectiveness of policy scenarios to deliver those outcomes)

| <b>Outcomes</b>               | <b>Current Baseline</b> | <b>Wales Only Regulator</b> | <b>Regulatory + Incentives</b> | <b>Market Lite</b> | <b>Full Market</b> |
|-------------------------------|-------------------------|-----------------------------|--------------------------------|--------------------|--------------------|
| Enhancing our Environment     | 55.4                    | 64.7                        | 52.1                           | 45.4               | 37.0               |
| Protecting People             | 53.3                    | 60.7                        | 47.6                           | 42.6               | 35.3               |
| Improving the Nation's Health | 52.9                    | 57.5                        | 48.3                           | 46.0               | 40.6               |
| Viable & Vibrant Places       | 46.5                    | 52.3                        | 44.3                           | 40.7               | 34.2               |
| Supporting Jobs & Enterprise  | 45.1                    | 49.6                        | 43.7                           | 40.7               | 34.0               |
| Supporting Skills & Knowledge | 39.3                    | 43.7                        | 37.4                           | 33.6               | 28.5               |
| Delivering Social Justice     | 39.0                    | 43.5                        | 37.1                           | 32.6               | 27.5               |

## Section 7

### Research Findings and Discussion

#### 7.1 Key outcomes for the future water and sewerage provision in Wales

In carrying out this research, one of the aims has been to establish the degree of alignment between the needs and requirements of business customers in Wales with the desired outcomes being sought for Wales by the Welsh Government.

In general, a good degree of alignment has been identified between the sustainable development-based outcomes of the Welsh Government and those of business customers. As a consequence, the overall framework provides a firm foundation for developing the water strategy for Wales.

Business customers reflect the diverse economic and social landscape of Wales, and as businesses, it is important to their success that sustainable growth can be achieved in the communities within which they operate. Business customers therefore recognise the need for the water industry in Wales to set outcomes that contribute to environmental, social and economic development. Equally, business customers rely on resilient, reliable and quality water and sewerage services to meet their specific business objectives. The key shared outcomes therefore focus on:

- **Protecting people and improving the nation's health** – focus on resilience and security of service, preventing surface water flooding, removing wastewater safely, maintain high standards of drinking water quality
- **Enhancing our environment** - focus on improving the local environment in order to support sustainable development and jobs, engender tourism growth and provide wider opportunities for local businesses, local authorities and community groups to work in partnership with water companies for mutual benefit
- **Viable and vibrant places** – focus on addressing river and bathing water quality to drive tourism and recreation, reduce the risks of surface water flooding and pollution to encourage inward

investment and development opportunities. Ensure infrastructure capacity is not a constraint on development.

Businesses value the role that water companies can bring to the support sustainable development of communities in Wales and are therefore supportive of policy developments that help bring a greater focus on delivering these outcomes.

#### 7.2 Priorities for business customers in Wales

Figure 27 sets out the headline priorities for business customers in Wales which build on the key outcomes discussed above. Customers are generally less concerned about the regulatory model to deliver on these priorities, but that whichever regime is in place, there is a strong focus on delivering them.

Price of water and sewerage services is generally not the principal driver for business customers, even for some intensive water-using customers. Other costs are of greater concern (e.g. business rates, energy bills), but reliability, resilience and quality of service are generally of greatest importance.

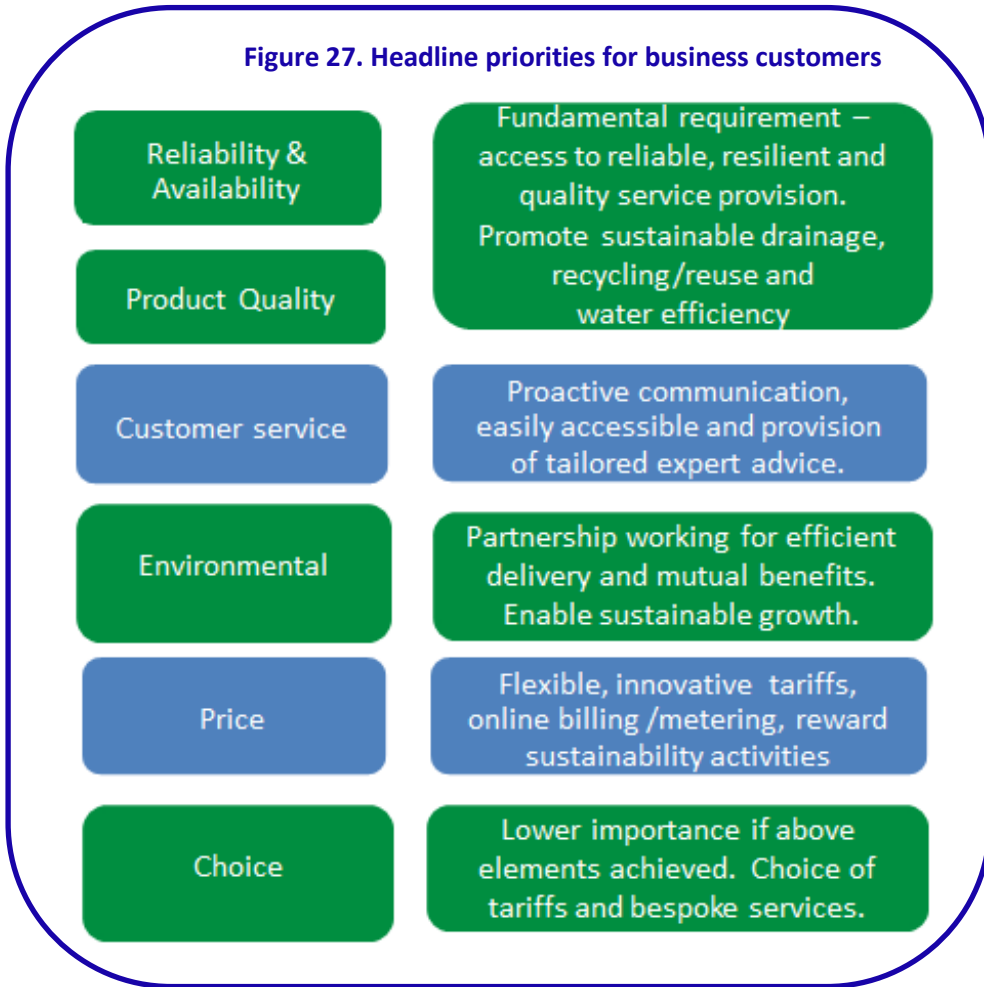
Most business customers are reasonably satisfied with the service they currently receive. Stakeholder feedback has not shown a strong push for significant reform, but rather evolution to improve the focus on customer priorities has been the main message along with greater flexibility to tailor services and tariffs, as well as providing easily accessible technical support and communication.

The not-for-profit model of Dŵr Cymru Welsh Water has generally been supported by its business customers, but there is a particularly strong pull from customers for greater engagement with businesses, public and third sector organisations on a range of issues, in particular:

- New connections and new development
- Sustainable drainage and sewerage systems
- Partnership working on environmental issues
- Provision of greater technical advice and services

These issues do not appear to be unique to Dŵr Cymru Welsh Water either - they were consistent messages across Wales in relation to the other incumbent water companies.

**Figure 27. Headline priorities for business customers**



### 7.3 Alternative policy scenarios

Four alternative policy scenarios were developed to test stakeholder views on the direction in which the water regulatory regime in Wales should move. The principal axis of debate is whether there should be greater levels of competition in the water industry for either retail services and/or wholesale activities, versus modifications to the existing regulatory-driven regime. There are strong views at either ends of the regulation-competition spectrum, but in general business customers have less strong views than suppliers, consumer groups and regulatory bodies. Business customers want their needs to be met efficiently and reliably, and therefore the “end” is more important than the “means”.

The evidence for the benefits of moving to a more competitive regime remains limited in practice, with little in the way of direct retail competition outside of the UK and equally few applicable examples of wholesale competition. Experience from other utility sectors is mixed, and many stakeholders expressed concerns about applying the energy or telecommunications models for water services. The majority of business customers questioned felt that a move towards full wholesale and retail competition would not deliver a net benefit to customers, and that a more evolutionary, step-wise approach would be more appropriate.

Many business customers expressed the view that the priorities set out for business customers could be achieved by modification of the existing regulatory regime supported by targeted legislative changes and/or government guidance to regulators.

Despite the planned moves in England towards retail (and subsequently beyond 2020 to wholesale) competition, most business customers did not see this as a particular issue in respect of a diverging regime between Wales and England. In many cases, such views were accompanied by reference to the Glas Cymru model as providing a greater benefit to customers in Wales compared to benefits that may accrue due to competition. Indeed, some stakeholders went as far to suggest that the Glas Cymru ownership model should apply throughout Wales,

representing a hybrid position between a publicly owned enterprise (such as Scottish Water) and the private equity ownership (as in England). There are advantages and disadvantages relating to each of the four alternative scenarios. All scenarios are likely to deliver the basic priorities of business customers, and therefore any distinct advantages or disadvantages of one scenario over the other are likely to be relatively marginal. It is therefore necessary to return to the objectives set out for water and sewerage provision in Wales to assess the direction in which any changes to the existing regime should follow.

### **Delivering against policy priorities**

The Welsh Government has set out a broad-based set of outcomes for its water strategy development founded on the principles of sustainable development. Policy priorities include a focus on:

- Catchment protection
- Water quality
- Sustainable resource management
- Multiple ecosystem services
- Safety, planning and resilience

Impact on water bills and affordability for water customers is also a key concern.

Table 3 summarises the advantages and disadvantages of each of the four scenarios in relation to these policy priorities. The table highlights that each scenario can bring some benefits to the policy priorities, but that the risks increase with scenarios involving greater level of competition.

### **7.4 Policy actions**

Based on the above discussions and findings, a wide range of policy actions have been identified to support achievement of the priorities for business customers. The breadth of these illustrates the varied nature of the business customer base in Wales and emphasises the need for a flexible approach to policy development – a “one size fits all” approach is unlikely to deliver the desired outcomes.

The policy actions can be grouped into 6 main areas (Figure 28), underpinned by a more general policy objective to build capability within Wales so that the country is recognised internationally as a centre of excellence for water (and natural resources) management.

**Table 3. Advantages (+) and disadvantages (-) of each policy scenario against Welsh Government policy priorities**

| Policy Priority      | Scenario 1<br>“Wales-only Regulator”   | Scenario 2<br>“Regulation + Incentives”  | Scenario 3<br>“Market Lite”   | Scenario 4<br>“Full Market”  |
|----------------------|--|--|---|--|
| Catchment protection | (+) Enables greater alignment of environmental and water regulation<br>(+) Vertical integration of water companies supporting holistic catchment approaches<br>(+) Partnership working encouraged through aligned objectives | (+) Outcomes based incentives and totex approach to cost efficiency encouraging catchment-based solutions<br>(+) Vertical integration of water companies supporting holistic catchment approaches              | (+) Vertical integration of wholesale water companies supporting holistic catchment approaches  | (+) Potential for greater innovation due to wider number of catchment operators<br>(+) More drive for added value services across wholesale operations, e.g. water efficiency, sustainable drainage  |
|                      | (-) Regulatory approach may not sufficiently encourage innovation  | (-) Regulatory approach may not sufficiently encourage innovation  | (-) Regulatory wholesale approach may not sufficiently encourage innovation<br>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into catchment protection   | (-) More operators involved, hindering holistic catchment approaches with other parties<br>(-) Short-term approaches being taken to keep costs low<br>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into catchment protection   |
| Water quality        | (+) Strong water safety plan approach within vertically integrated wholesale and retail operations<br>(+) Clear line of communications for business customers and regulators in event of water quality failure               | (+) Strong water safety plan approach within vertically integrated wholesale and retail operations<br>(+) Clear line of communications for business customers and regulators in event of water quality failure | (+) Pressure may exerted by retailer on wholesaler to respond to water quality concerns of business customers more rapidly  | (+) Potential for greater innovation in drinking water quality improvements<br>(+) Pressure may exerted by retailer on wholesaler to respond to water quality concerns of business customers more rapidly  |
|                      | (-) Lack of competition may lead to business customers experiencing a less responsive approach to their water quality concerns   | (-) Lack of competition may lead to business customers experiencing a less responsive approach to their water quality concerns   | (-) Risk that business customers and regulators are unsure of who to contact in the event of a water quality failure<br>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into addressing water quality issues | (-) Multiple operators – less co-ordination and increased risk of service failures<br>(-) Difficult for business customers to know who to contact in the event of a water quality failure<br>(-) Speed of response hindered for ‘supplier of last resort’<br>(-) Greater mixing of water supplies increases risk of water quality failures |

|  |   |  |  |  |
|--|---|--|--|--|
|  |   |  |  | or taste/odour/appearance issues<br>(-) Increased costs for investment in water quality monitoring communications  |
| <b>Sustainable resource management</b> | (+) Enables greater alignment of environmental and water regulation<br>(+) Vertical integration of water companies supporting sustainability<br>(+) Partnership working encouraged through aligned objectives | (+) Outcomes based incentives and regulatory performance measures drive sustainability measures<br>(+) Vertical integration of water companies supports integrated focus on sustainability | (+) More drive for added value services to business customers, e.g. water efficiency or wastewater recycling advice<br>(+) Vertical integration of wholesale water companies supports integrated focus on sustainability | (+) Potential for greater innovation due to wider number of operators<br>(+) More drive for added value services to business customers, e.g. water efficiency or wastewater recycling advice   |
|  | (-) Regulatory approach may not sufficiently encourage innovation   | (-) Regulatory approach may not sufficiently encourage innovation  | (-) Regulatory wholesale approach may not sufficiently encourage innovation<br>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into sustainability  | (-) More operators involved, hindering holistic catchment approaches with other parties<br>(-) Short-term approaches being taken to keep costs low<br>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into sustainability |
| <b>Multiple ecosystem services</b>     | (+) Greater linkage to Welsh environmental legislation focused on ecosystem services<br>(+) Partnership working encouraged through aligned objectives   | (+) Outcomes based incentives and totex approach to cost efficiency encouraging consideration of ecosystem services thinking   | (+) Retail partnerships may evolve to help support ecosystem service approaches  | (+) Potential for greater innovation may help introduce alternative approaches to management of ecosystem services   |
|  | (-) Potential regulatory barriers to embrace ecosystem services   | (-) Potential regulatory barriers to embrace ecosystem services  | (-) Focus is on short-term costs rather than wider and longer-term issues relating to ecosystem services   | (-) Focus is on short-term costs rather than wider and longer-term issues relating to ecosystem services   |
| <b>Safety, planning and resilience</b> | (+) Vertical integration of water companies support strong resilience and aid long-term planning  | (+) Vertical integration of water companies support strong resilience and aid long-term planning   | (+) Potential for added value services in relation to on-site resilience for business customers  | (+) Potential for added value services in relation to on-site resilience for business customers  |
|  | (-) Regulatory approach may not sufficiently encourage innovation   | (-) Regulatory approach may not sufficiently encourage innovation  | (-) Retail operators focused on cost savings rather than long-term planning and resilience<br>(-) Lack of co-ordination between competitors for planning and   | (-) Short-term approaches to keep costs low prevents long-term investment in resilience and long-term considerations<br>(-) Stranded assets will reduce  |

|   |   |   |   |  |
|---|---|---|---|--|
|   |   |   | <p>resilience</p> <p>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into resilience</p>   | <p>resilience</p> <p>(-) Multiple operators – less co-ordination and increased risk of service failures</p> <p>(-) Risk of lower returns for Dŵr Cymru, with reduced re-investment of profits into resilience</p>  |
| <p><b>Potential impact on water bills</b></p> | <p>(+) High level of bill certainty for business customers for 5 years</p> <p>(+) Enables more direct guidance on tariffs to support businesses</p> <p>(+) Regulatory efficiency targets can be set for business retail operations to help keep bills low</p> <p>(+) Majority of business customers in Wales served by a not-for-profit company</p> | <p>(+) High level of bill certainty for business customers for 5 years</p> <p>(+) Regulatory efficiency targets can be set for business retail operations to help keep bills low</p> <p>(+) Majority of business customers in Wales served by a not-for-profit company</p> <p>(+) Outcome based incentive regime drives performance within a regulated price regime</p> | <p>(+) Retail competition drives focus on cost reduction, lowering bills</p> <p>(+) Greater scope for tariff flexibility to meet business requirements</p>  | <p>(+) Competition drives focus on cost reduction across retail and wholesale</p> <p>(+) Greater scope for tariff flexibility to meet business requirements</p>  |
|   | <p>(-) Less comparative regulation possible – risk of reduced efficiencies to keep bills as low as possible</p> <p>(-) Risk of increased administrative costs and regulatory burden leading to increased costs</p> <p>(-) Lack of competition may not drive efficiencies beyond regulatory target</p>   | <p>(-) Lack of competition may not drive efficiencies beyond regulatory target</p>  | <p>(-) Allowed profit margins may be higher to offset risks; efficiency savings not guaranteed to be passed on to customers</p> <p>(-) Risk of cross-subsidy from household customers, increasing household bills</p> <p>(-) Additional costs for market set-up and administration passed on to customers</p> <p>(-) Risk of ‘cherry picking’ of ‘attractive’ business customers, leading to higher costs for remaining</p> | <p>(-) Allowed profit margins may be higher to offset risks; efficiency savings not guaranteed to be passed on to customers</p> <p>(-) Risk of cross-subsidy from household customers, increasing household bills</p> <p>(-) Additional costs for market set-up and administration passed on to customers</p> <p>(-) Risk of ‘cherry picking’ in both wholesale and retail sectors, reducing ability for bills to kept low through</p> |



|  |  |  |   |  |
|--|--|--|---|--|
|  |  |  | <p>business customers of incumbent</p> <ul style="list-style-type: none"> <li>(-) Small businesses unable to take advantage of lower charges linked to prompt payment discounts</li> <li>(-) Reduced certainty of future bills</li> </ul> | <p>regional cost averaging</p> <ul style="list-style-type: none"> <li>(-) Risk of stranded assets, leading to inefficiencies</li> <li>(-) Increased uncertainties for investors leading to higher cost of capital and therefore upward pressure on water bills</li> <li>(-) Reduced certainty of future bills</li> <li>(-) Increased costs due to need for 'supplier of last resort' safeguards</li> </ul> |
|--|--|--|---|--|

## 7.5 Policy on retail competition threshold

Increasing competition in the business customer market by lowering the threshold below 50 million litres per year is not considered to provide an overall *better* set of outcomes for business customers in Wales. Key reasons underpinning this view are:

- Risks that market set-up and administrative costs will offset any potential bill savings.
- Efficiencies are not realised by retailers, with consequent lack of price reductions. Conversely, water companies wholly or mainly in Wales will be set regulatory efficiency targets for business retail operations in price limits.
- Ofwat guidance for the 2014 price determination indicates a suggested business customer retail profit margin of 2.5% for companies wholly or mainly in England to reflect increased risks (Ofwat, 2014a). Conversely, the suggested margin is only 1% for companies wholly or mainly in Wales.
- Small business customers are less likely to be able to take advantage of discounts for prompt payment which have been a key component of retail offerings in Scotland. Small businesses may end up subsidising larger businesses.
- Risks that discounts for business customers are funded by cross-subsidy from household customers.
- Risk of confusion for business customers as to who to contact when there are service failures such as sewer flooding or temporary loss of supply (rather than billing or metering issues).

Sewerage services are not currently open to retail competition. Business customers consuming more than 50 million litres per year can only choose their water supplier. This is considered an anomaly, hindering single billing and combined added value services to eligible customers at a single site. This is being addressed in England through the Water Bill and it is considered appropriate to also extend these provisions to Wales.

## 7.6 Policy on inset appointments

As set out in Section 5, there were mixed views on the role of inset appointments in delivering outcomes for business customers. However, on balance, the potential disadvantages cited are outweighed by the potential advantages in respect of greater scope for innovative water management solutions, particularly for new developments (e.g. sustainable drainage and wastewater treatment; rainwater harvesting) and integrated water and energy efficiency measures. On this basis, one of the policy actions for delivery of sustainable new developments is to address the barriers to inset appointments (Figure 28). This particularly includes review of the basis of bulk supply pricing from incumbents to appointees.

The current large user threshold for inset appointments for single sites in Wales is 250 million litres compared to 50 million litres per year in England; this is at variance to the current threshold in Wales for business customers to choose their retail water supplier (50 million litres per year). It is considered that reducing the inset appointment threshold to 50 million litres per year would provide greater opportunity for innovation as well as provide further regulated competitive and reputational pressure on the incumbent water companies to drive efficiencies and customer service improvements.

Lowering the threshold would need to be accompanied by modifications to the regulatory requirements for NAVs to ensure a focus on setting out the benefits to customers (price, service and value added) and to the environment from innovation, with key measurable outcomes defined against which success can be assessed by Ofwat.

However, before further steps are taken to encourage further inset appointments, the regulatory issue relating to the governance of appointees needs to be resolved. As explained in Section 5, a company whose first inset appointment is made in England continues to be regulated by the UK Government even though it could subsequently apply for and operate inset appointments in Wales in the future. This

could lead to fragmentation of regulatory powers of the Welsh Government over areas of Wales if the number of inset appointees increases. Potential solutions to this issue are currently being explored.

The current inset appointment/NAV regime in Wales is different to that in England with a higher threshold volume (250 million litres per year)

important to reiterate that the regulatory regime is the “tool” and not an outcome in itself. The focus must be on the desired outcomes.

## 7.7 Key features for a future water regulatory regime

The overall focus on integrating environmental, social and economic outcomes means that any future regime for water and sewerage provision will need to be capable of delivering against these outcomes. Key features of the regime would need to enable:

- Strong partnership working with other organisations in the public, private and “third” sector
- Holistic approaches to managing the water environment at the catchment or sub-catchment scale
- Innovative approaches to addressing water environmental issues, support green growth for rural communities and sustainable drainage solutions
- Responsive approach to meet business needs and priorities, with greater service and technical support
- Flexibility in tariffs and support/reward for water efficiency, sustainable drainage and wastewater re-use and recycling
- Proactive partnerships with developers and local authorities to drive new, sustainable developments

It is considered that such a regime would likely sit more towards the regulatory pole of the regulatory-competition axis, but ensuring that existing competitive pressures are not lost and seeking targeted opportunities for introducing greater “regulated competition” opportunities where appropriate to encourage the innovative approaches that will be key to delivering the Welsh Government outcomes. It is

Figure 28. Policy Actions

### Support for sustainable new developments

- \* Greater engagement with developers & local authorities
- \* Innovative, sustainable water & sewerage solutions
- \* Address barriers to inset appointments & developers

### Sustainable drainage

- \* Clarify ownership & responsibility for drainage assets
- \* Resolve regulations on SUDS
- \* Encourage partnership funding & collaboration between drainage system owners

### Encourage Innovation

- \* Consider innovation incentives for water companies & supply chain
- \* Encourage innovative solutions between business customers, public sector bodies & water companies
- \* Maximise use of technology funds

### Rural communities

- \* Improve access to public water & sewerage systems
- \* Integrate measures with other rural infrastructure provision
- \* Partnership working with agricultural & land managers
- \* Application of market-based instruments

### Tariff innovation

- \* Regulatory reform to enable greater tariff flexibility
- \* Greater incentives/rewards for water efficiency, sustainable drainage, recycling and reuse
- \* Tariff innovation to better reflect business requirements

### Water efficiency

- \* Encourage extension of water efficiency labelling
- \* Innovation in leak detection
- \* Greater advice and services for business customers
- \* Greater integration of water and energy efficiency services

Develop capability:  
Wales as a centre of excellence for water management

## Section 8

### Recommendations

In developing the water strategy, the Welsh Government has set out clear outcomes for Wales. Any changes to the water regulatory regime must therefore be developed to support achievement of these objectives, which have a broad social, economic and environmental basis. Decisions also need to acknowledge that the dominant incumbent water and sewerage company in Wales has a 'not-for-profit' business model.

Evidence from business customer stakeholder engagement has shown that there is close alignment between business customer priorities for water and sewerage services and the Welsh Government outcomes. This alignment provides confidence that measures proposed to meet the Welsh Government outcomes are also likely to meet those of business customers.

#### It is recommended that:

1. The existing regulatory regime and those proposed by Ofwat to come into force from 2015 for companies wholly or mainly in Wales (and those for Severn Trent Water aligned to changes in England) should form **the basis** of any future changes to the water industry regime.
2. The Welsh Government should seek devolution of sewerage legislative competence to address this current anomaly, building on the recommendations of the Silk Commission (2014).
3. The largest business customers using greater than 50 million litres of water per year should be able to choose their retail sewerage provider as well as their retail water supplier.
4. The current volumetric consumption threshold for business customers choosing their retail water supplier should be retained at 50 million litres per year.
5. Additional measures to encourage and further evolve the Inset Appointment/NAV process should be considered, particularly in the

context of innovation and integrated solutions for energy and water, sustainable drainage and wastewater treatment. As discussed in Section 7.6, this includes lowering the large user threshold for inset appointments for single sites to 50 million litres per year. The benefits to customers from inset appointments should be made more explicit and transparent in applications. This would also continue to provide regulated competitive and reputational pressure on the incumbent water companies to help drive efficiencies and customer service improvements.

However, before further steps are taken to encourage further inset appointments, the regulatory issue relating to the governance of appointees needs to be resolved. As explained in Section 5, a company whose first inset appointment is made in England continues to be regulated by the UK Government even though it could subsequently apply for and operate inset appointments in Wales in the future. This could lead to fragmentation of regulatory powers of the Welsh Government over areas of Wales if the number of inset appointees increases. Potential solutions to this issue are currently being explored.

6. The water strategy outcomes and priorities for business customers are best served by retention of the vertical integration of wholesale (or upstream) operations, enabling integrated catchment solutions to be developed.

7. Comparative regulation should continue through Ofwat using data available from England and Wales, with a clear remit from the Welsh Government to compare water bills and customer service for business customer retail, household retail and wholesale elements of each water company. In this way, the relative benefits of competition can be compared and added to the evidence base. The WICS should also be asked to provide similar comparative data for Scotland.

8. The six key policy action areas outlined in Figure 28 should be developed further jointly by Welsh Government in consultation with Ofwat and CCWater, and with support as appropriate from Natural

Resources Wales, the Welsh Local Government Association, other relevant NGOs, water companies and appropriate trade and business representatives.

9. The creation of a Wales-only water economic regulator is not recommended given that the vast majority of the water regulatory regime remains common between England and Wales, and therefore the set up and ongoing administrative costs are not justified. The Welsh Government already has powers under the Water Industry Act 1991 (as amended) to provide guidance to Ofwat on social and environmental matters.

10. Ofwat and Defra should confirm that the necessary safeguards will be put in place to ensure set-up and maintenance costs for retail competition in England (and the Anglo-Scottish market arrangements) are not passed on to water companies that operate wholly or mainly in Wales.

11. The potential for water and sewerage legislation to be enforced according to national political boundaries should be explored further, building on the recommendations of the Silk Commission (2014). Amongst other benefits, this would ensure democratic accountability for any concerns raised by business customers as to eligibility for retail competition or other future legislative changes. The timing of any transition should consider the impact on water company retail operational changes that will be needed to reflect the different retail market regimes in Wales and England.

12. The Welsh Government should work with Ofwat, CCWater and the water companies to ensure strong communications and information are made available to business customers about eligibility for retail competition, particularly those customers in cross-border areas, to avoid any confusion.

13. The Ofwat Service Incentive Mechanism (SIM) for business customers supplied by companies wholly or mainly in Wales should be strengthened (compared to the draft published in October 2013) to include comparison

with performance of English water companies in relation to business customers. This should include CCWater's compilation of customer service performance and complaints for all water companies in England and Wales.

Consideration should also be given for the SIM to provide greater incentives (reward) than currently proposed to improve customer service. This should be set within the context of the final Outcome Delivery Incentive proposed by Dŵr Cymru Welsh Water for the next price review period relating to non-household customer service.

14. The Welsh Government's water strategy should include a measure of success related to business customer satisfaction, tested in concert with CCWater market research with business customers in Wales.

## References

Cave, M. (2009), Independent review of competition and innovation in water markets. Final Report, April 2009.

Consumer Council for Water (2014), Response to the Ofwat consultation on Service Incentive Mechanism (SIM) for 2015 onwards. January 2014.

Consumer Council for Water (2013), Forward work programme for Wales 2013-14 to 2015-16.

Consumer Council for Water (2010), Small and medium business customer views on competition in the water and sewerage industry.

Consumer Council for Water (2007), Setting strategic direction: research into competition with business customers.

Commission on Devolution in Wales (2014), Empowerment and responsibility: legislative powers to strengthen Wales. March 2014.

Customer Challenge Group (2013), Customer Challenge Panel Report on the Dee Valley Water plc Business Plan. December 2013.

Customer Challenge Group (2013), Customer Challenge Group Report on the Dŵr Cymru Welsh Water Business Plan. December 2013.

Dee Valley Water (2013), Business Plan for 2015-2020. December 2013.

Defra (2011), Water for Life White Paper. December 2011.

Dŵr Cymru Welsh Water (2013), Business Plan 2015-2020. December 2013.

Dŵr Cymru Welsh Water (2009), Response to the “Independent review of competition and innovation in water markets”.

ICS Consulting (2011), In whose hands? Exploring vertical integration in the water industry: a report for United Utilities.

National Assembly for Wales (2013), Inquiry into water policy in Wales. Environment and Sustainability Committee. August 2013.

Ofwat (2014a), Setting price controls for 2015-20 – risk and reward guidance. January 2014.

Ofwat (2014b), New appointments and variations – a statement of our policy. January 2014.

Ofwat (2014c), Setting price controls for 2014-15 – pre-qualification decisions. March 2014.

Ofwat (2013a), Ofwat SIM survey: 2012/13 annual report. April 2013.

Ofwat (2013b), Service Incentive Mechanism (SIM) for 2015 onwards – a consultation. October 2013.

Ofwat (2013c), Setting price controls for 2015-20: final methodology and expectations for companies’ business plans. July 2013.

Ofwat (2011a), Ofwat’s review of the evidence base for retail competition and separation. December 2011.

Ofwat (2011b), Future price limits – a consultation on the framework. November 2011.

Ofwat (2009), Variation of SSE Water's Appointment to include Llanilid. April 2009.

Open Water Programme (2014), Market Blueprint. January 2014.

Open Water Programme (2013a), Market Reform Programme: Framework Document. December 2013.

Open Water Programme (2013b), The new retail market for water and sewerage services: a discussion paper. June 2013.

Scottish Public Services Ombudsman (2013), Annual complaints report 2012–2013: water.

Scottish Water (2013), Annual Report and Accounts 2012-13.

Severn Trent Water (2013), Better value, better services and a healthier environment: Severn Trent Water Business Plan 2015–20. December 2013.

UK Government (2013), Water Bill. Laid before Parliament: June 2013.

UK Government (2012), Draft Water Bill. July 2012.

Water Industry Act 1991 (as amended)

Water Industry Commission for Scotland (2013), Water and sewerage services in Scotland: an overview of the competitive market.

Water Industry Commission for Scotland (2011a), Retail competition: The story so far, the journey to come.

Water Industry Commission for Scotland (2011b), Retail Competition in Scotland: an audit trail of the costs incurred and the savings achieved.

Water Industry Commission for Scotland (2011c), Introducing retail competition in the UK water/waste water sector: a lessons learned paper. March 2011.

Welsh Government (2013), Towards the sustainable management of Wales' Natural Resources: consultation on proposals for an Environment Bill. October 2013.

Welsh Government (2012), Sustaining a living Wales: A Green Paper on a new approach to natural resource management in Wales.

Welsh Government (2011), Strategic Position Statement on Water 2011. February 2011.

Welsh Assembly Government (2009a), Strategic Position Statement on Water. January 2009.

Welsh Assembly Government (2009b), One Wales: One Planet: the sustainable development scheme of the Welsh Assembly Government. May 2009.

Welsh Assembly Government (2006), Environment Strategy for Wales.



## APPENDIX A

### Approach to stakeholder engagement

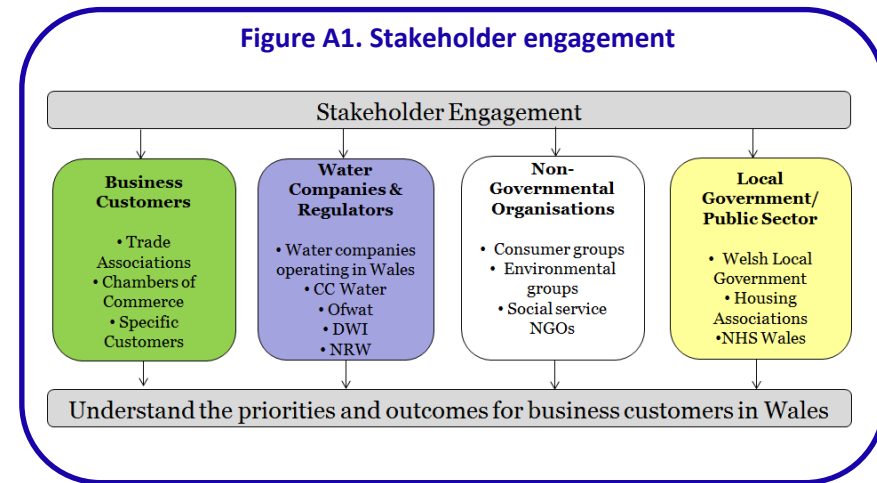
#### Stakeholder community

The research team has sought to engage with a wide cross-section of stakeholders (Figure A1) in order to gather a diverse range of views and opinions from different sectors of business customers in Wales as well as other parts of the Welsh economy and Welsh society. Given the broad sustainability and ecosystem approach underpinning the development of natural resources management in Wales and the water strategy, it was considered important to explore views across a wide a range of stakeholders as possible.

The stakeholder engagement took place against the backdrop of extensive engagement activity within Wales in relation to water and sewerage policy and strategy, as well as wider consultation on environmental policy and legislation as described in Section 3. This had two key consequences for this research project:

- a) Stakeholders were generally well informed and had a good understanding of the issues
- b) There was often a sense of “consultation fatigue” with stakeholders expressing a view that they “had already been consulted” by Welsh Government, their local water company (for the 2014 price review), by Consumer Council for Water or had given evidence to the National Assembly inquiry into water policy in Wales.

As a consequence of these factors, there was some general reluctance to engage but, where engagement took place, the discussions were based on a considered understanding of the policy context and debate. The evidence gained from this stakeholder engagement activity should therefore build on earlier stakeholder consultation activities.



#### Stakeholder engagement activities

Various approaches were used to engage with stakeholders on a confidential basis (Box A1).



Stakeholders were reassured that all comments and opinions provided would be synthesised into summary comments and not attributed to any individual or organisation, unless express permission was given to include an attributed comment in the reporting to Welsh Government. By assuring confidentiality, stakeholders were able to give their opinions in a

safe environment and ensure that the evidence obtained was based on frank and open dialogue.

### Structured Interviews

Structured interviews took place on both a face-to-face basis where feasible and also by telephone. The interviews were structured according to the stakeholder cohort (e.g. water company, business customer or trade organisation, NGOs), but with a consistent objective of seeking feedback and opinions on:

- Welsh Government outcomes for natural resources management and, more specifically how these outcomes relate to services and future challenges of water and sewerage provision. Table A1 was developed to help stakeholders make the link between the Welsh Government outcomes and water and sewerage provision.
- Business customer views on the key attributes of current water and sewerage service provision (Figure A2)
- Future needs and priorities for business customers for water and sewerage provision for each key service attribute (Figure A2)
- The four alternative policy scenarios (see Section 4 of main report).

### Workshops

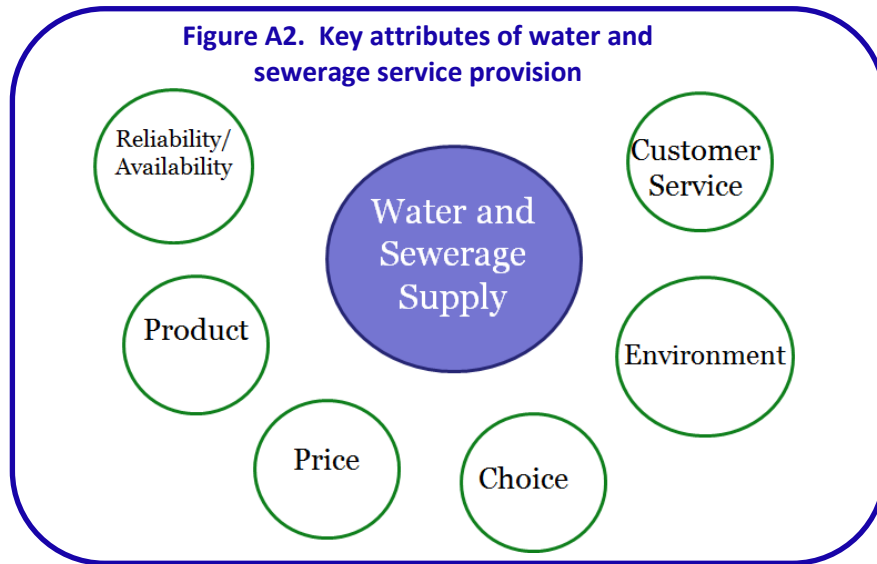
Two group workshops were held in November 2013: one in Cardiff and one in Wrexham. Over 60 business customers and representative groups from across Wales were invited to attend these workshops. Although the attendance rate was relatively low (21%), the workshops enabled detailed discussions to be held with attendees on the key areas shown in Box A2. This provided a “rich picture” to be gained from business customers on their views and opinions. The workshop invitations also led to further requests for telephone interviews from representatives from organisations that were unable to attend the workshop itself. The workshops comprised a range of qualitative and quantitative approaches

to assessing views and opinions. The findings have been combined with those from other stakeholder activities as reported in Section 5 of the main report.

**Table A1. Linking Welsh Government outcomes for natural resources management to water and sewerage provision**

| Welsh Government Outcome        | Water & Sewerage Provision Focus   |
|---------------------------------|--|
| Enhancing Our Environment       | Catchment Management, Wider Ecosystem Service Benefits, Renewable Energy, Water Efficiency               |
| Protecting People               | Flood Protection, Resilient Infrastructure, Water Quality  |
| Supporting Enterprise and Jobs  | Infrastructure & Capacity Planning, Shellfish Waters, Security of Supply, Flood Protection               |
| Improving the Nation’s Health   | Drinking Water Quality, Public Health Education, Recreation on Catchment Land, Tackling (Sewer) Flooding |
| Viable and Vibrant Places       | Bathing Water Quality, River Water Quality, Sustainable (Urban) Drainage, Resilient Infrastructure       |
| Delivering Social Justice       | Affordability, Bad Debt, Metering, Customer Service  |
| Supporting Skills and Knowledge | Innovation & New Technology, Apprenticeships & Graduate schemes, University Partnerships                 |

**Figure A2. Key attributes of water and sewerage service provision**



**Box A2. Key areas explored at group workshops**

3 hour workshops (Wrexham and Cardiff)

Business customer views sought on:

- current service provision for water and sewerage, future needs and priorities
- water and sewerage service provision in the context of Welsh Government outcomes
- water and sewerage service provision compared with other utility sectors where greater choice and competition exists

### *Multi-Criteria Analysis and on-line survey*

In order to seek wider, quantitative views from stakeholders, a multi-criteria analysis approach was adopted incorporating an on-line survey questionnaire. The approach is set out in Appendix B and results reported in Section 6 of the main report.

## APPENDIX B Multi-Criteria Analysis Approach

### Multi-Criteria Analysis: overview

To inform the stakeholder engagement and evidence gathering, a Multi Criteria Analysis (MCA) approach was adopted to gather quantitative information and enable objective analysis of stakeholder views on the “baseline” and four scenario options.

MCA is a well-established approach to evaluating alternative policy options in lieu of quantifiable economic evidence. Various impact assessments have been undertaken by Ofwat, Defra and independent commentators to quantify the potential costs and benefits of introducing competition into the water and sewerage sectors in England and Wales. However, the assumptions used in the assessments have been subject to considerable challenge and/or have not included specific analyses on the consequences for customers in Wales. Additionally, it is recognised that the existing cost benefit analyses focus on a narrow range of economic based measures (i.e. quantifiable monetary values) and do not consider the wider outcomes that the Welsh Government has set for managing and deriving value from the water industry and natural resources more broadly within Wales.

MCA offers an attractive approach as:

- There is a lack of quantifiable information relating to how the Welsh Government’s outcomes for natural resources management may be affected by changes in the legislative and regulatory regime for water and sewerage provision.
- It is difficult to isolate the specific impacts from any changes to water and sewerage provision from wider policy impacts, for example due to the Environment Bill, Future Generations Bill, Environment Planning Reform, Housing, Heritage and Access Bill, which would need to be considered due to the overlap with

activities such as sustainable urban drainage, catchment management and water abstraction.

- It enables wider considerations to be taken into account rather than a narrow range of effects. The recent cost-benefit impact analysis for the High Speed Railway 2 (HS2) undertaken for the UK government has been criticised for only considering the direct impact of HS2 investment rather than the wider impacts of investment in overall transport facilities, and thus misrepresenting the potential monetary costs and benefits.
- MCA provides a platform for eliciting views on policy options from a diverse range of stakeholders and enabling an objective and transparent evaluation approach to be applied. This is of particular relevance for this project where stakeholder engagement with a wide variety of customers, regulators, public bodies, trade bodies, NGOs and companies form a core part of the analysis.
- MCA enables a standardised approach to capturing diverse views. The facilitation of inclusion and involvement in policy appraisal are often cited as success factors in the application of MCA in a policy context.
- MCA approaches have been widely used in the policy arena, particularly in relation to water, sewerage and land use activities. This recognises the importance of engaging stakeholders in policy development and involving people in the analysis process.

### Multi-Criteria Analysis: application

An MCA approach was used to build on the qualitative stakeholder evidence in order to provide a quantitative assessment and evaluation of stakeholder views on the existing baseline conditions and the four alternative policy scenarios.

The approach focused on testing stakeholder views on:

- The importance and priority of the Welsh Government outcomes for natural resources management
- The effectiveness of the baseline and four alternative policy scenarios in achieving the Welsh Government outcomes
- The importance of key attributes of water and sewerage provision to business customers in Wales
- The impact of the baseline and four alternative policy scenarios on the key attributes of water and sewerage provision for business customers.

A structured, on-line survey questionnaire was developed (see below) following pilot testing, including background information to provide context for respondents. The information included details about market and regulatory reform proposals, the structure of water and sewerage provision in Wales, a summary of the Welsh Government outcomes for natural resources management and relevance to water and sewerage provision. Information on the “baseline” and alternative policy scenarios was also provided.

The questionnaire asked respondents to rate their views on a scale of 1 to 10 for each Welsh Government outcome or key attribute of water and sewerage provision against the baseline and the four alternative policy scenarios (see below).

The survey questionnaire was hosted on an external survey website with access to the results restricted to the research team via electronic password control. Using external market research databases of businesses in Wales, a sample of 1000 business customers in Wales was generated to ensure coverage across all parts of the country, all sizes of businesses and all economic sectors (as defined by the Standard Industrial Classification). Email invitations were sent to these business customers to complete the on-line survey, with contact details for the research team provided to address any queries or concerns.

## Multi-Criteria Analysis: on-line survey questionnaire

The on-line survey questionnaire is reproduced below:

### Page 1 - Welcome

Thank you for agreeing to take part in this important survey.

The survey aims to gain your organisation's thoughts and opinions on your priorities for the future of the Water and Sewerage Industry in Wales. We will also be asking you about which policy options you think will best deliver your organisation's priorities, and those set out by the Welsh Government.

The survey should take less than 10 minutes, and all answers you provide will be strictly anonymous.

### Page 2 - Purpose of this survey

Cascade Consulting, supported by ICS consulting, are currently working on a project for the Welsh Government on "Delivering Results for Water and Sewerage Customers in Wales", which will help inform the upcoming Welsh Government Water Strategy.

As part of this research, it is important that the views and opinions of non-domestic and business water and sewerage customers in Wales are collected. This survey forms part of a number of customer engagement activities that have been carried out for the project.

The survey will ask you for the views on the priorities for water and sewerage provision in Wales for your organisation, and the potential policy options that could deliver those priorities and Welsh Government Outcomes.

## Page 3 - General Information

\* 1. Does your organisation currently operate in Wales?

Yes  No

\* 2. Does your organisation currently receive water and/or sewerage services for its operation in Wales?

Yes  No

\* 4. Please indicate who your current water and/or sewerage provider is in Wales.

- Dwr Cymru Welsh Water
- Severn Trent
- Dee Valley
- Prefer not to say
- Other
- If other, please specify.

**Page 4 - Current Water and Sewerage Provision**

The following questions will ask you to rate your current supply of water and sewerage services at your organisation's premises.

- \* 5. Thinking about the current PRODUCT you receive, in terms of the quality of water arriving at your premises, and the reliability of waste water being removed from your premises, please rate on a scale of 1 to 10 (with 1 being poor, and 10 being excellent) this aspect of service.

|                        | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|------------------------|---|---|---|---|---|---|---|---|---|----|
| Current PRODUCT rating | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 6. Thinking about the current PRICE you pay for your water and sewerage services, please rate on a scale of 1 to 10 (with 1 being poor, and 10 being excellent) this aspect of service.

|               | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|---------------|---|---|---|---|---|---|---|---|---|----|
| Current PRICE | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |



- \* 7. Thinking about the current CUSTOMER SERVICE you receive, in terms of any billing or account requirements for your water and sewerage provision, please rate on a scale of 1 to 10 (with 1 being poor, and 10 being excellent) this aspect of service.

|                          | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|--------------------------|---|---|---|---|---|---|---|---|---|----|
| Current CUSTOMER SERVICE | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 8. Thinking about the current CHOICE of water and sewerage provider, in terms being able to switch your provider if you wish to do so, please rate on a scale of 1 to 10 (with 1 being poor, and 10 being excellent) this aspect of service.

|                | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|----------------|---|---|---|---|---|---|---|---|---|----|
| Current CHOICE | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 9. Thinking about the current ENVIRONMENTAL services your water and sewerage provider engages in (e.g. undertaking sustainable projects such as catchment management or sustainable drainage schemes), please rate on a scale of 1 to 10 (with 1 being poor, and 10 being excellent) this aspect of service.

|                       | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-----------------------|---|---|---|---|---|---|---|---|---|----|
| Current ENVIRONMENTAL | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 10. Thinking about your current water and sewerage services provider, in terms of how they ensure AVAILABILITY, RELIABILITY and SECURITY of water supply or removal of waste water, please rate on a scale of 1 to 10 (with 1 being poor, and 10 being excellent) this aspect of service.

|                      | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|----------------------|---|---|---|---|---|---|---|---|---|----|
| Current AVAILABILITY | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

Thank you for rating your current water and sewerage services.

On the next page, we will explain the principles behind the current legislative and regulatory framework in which water and sewerage companies operate. This will provide you with some background to how your current water and sewerage services are provided.

**Page 5 - Regulatory and Legislative Background**

Currently, the services you receive are delivered through a legislative and regulatory framework that operates across England and Wales, and all Water and Sewerage Companies are subject to the same rules. The current framework can broadly be characterised as:

- Requiring water and sewerage companies to operate within a detailed set of "regulatory" targets, which are the levels and standards of service that companies must provide.
- There are modest "incentives" for water and sewerage companies to meet regulatory targets for customer service, and companies are strongly "penalised" by fines and deterrents if there is a failure to meet the targets.
- Very little scope for competition, or the use of "market forces" to shape the way companies behave and operate.

However, there are changes that could be made to the regulatory and legislative framework in which companies operate, to encourage different ways of delivering different priorities and outcomes.

The following page will set out 4 alternative options for a regulatory and legislative framework. A brief description of each option and a diagram has been provided. Please take a few moments to familiarise yourself with these options, as we will then be asking you to rate how you see each option delivering aspects of water and sewerage provision.

## Page 6 - Alternative Options

Please read the following descriptions carefully. Each option relates to a different regulatory and legislative framework that could be applied to the provision of water and sewerage services in Wales.

### Option 1: WALES-ONLY REGULATOR

In this option, the economic regulatory and legislative administration of the water industry in Wales would be transferred from the UK Government, to the Welsh Government. This would be consistent with the way environmental regulation has been transferred from the English Environment Agency to Natural Resources Wales.

The Welsh water industry would operate in a similar way to the current framework, but there would be opportunities to set water and sewerage companies in Wales specific targets that align with the Welsh Government Outcomes and the priorities of Welsh Citizens.

### Option 2: REGULATORY + INCENTIVES

In this option, the framework for delivering water and sewerage services would be very similar to the current situation, but water and sewerage companies would be subject to a framework of stronger incentives that would apply in both Wales and England.

Option 2 would be managed by the England & Wales Regulator "The Water Services Regulation Authority" (known as Ofwat). Although there will be some mechanisms to encourage regional water companies to deliver priorities specific to

their own customers, the overall regulatory and legislative framework would be applied across all of England and Wales.

Non-domestic and business customers in Wales would not be able to switch their water customer services (retail) supplier unless they use over 50 million litres per year on each site. However, sewerage customer services would remain with the existing supplier.

### Option 3: MARKET 'LITE'

In this option, non-domestic and business customers would be able to switch the customer service (retail) aspect of their water and sewerage suppliers, irrespective of their water usage, to any water and sewerage company in the UK offering retail customer services.

There would be minimal regulatory targets imposed on water and sewerage customer service companies, as it is anticipated that they will need to deliver what the customer wants in order to retain customers and market share.

The physical supply of water and sewerage services (i.e. the pipe networks and treatment centres connected to your property) would not be open to competition from different water and sewerage providers, so would still be provided by the existing supplier. These would still be regulated by Ofwat.

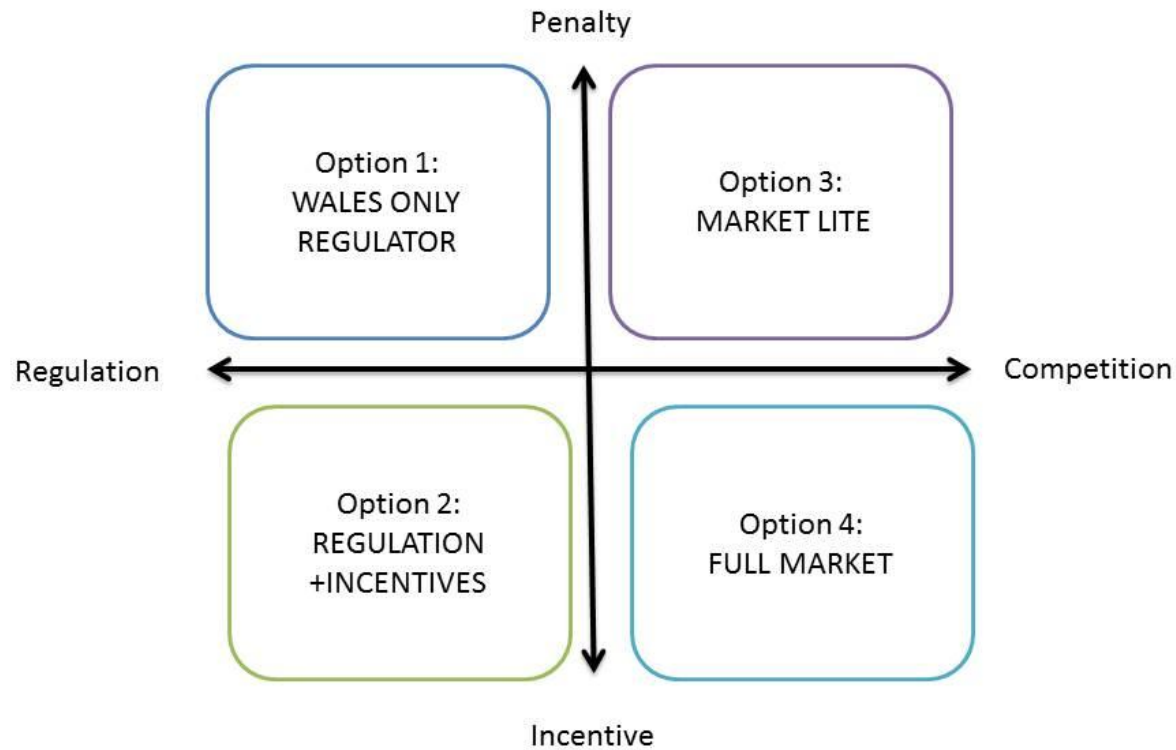
### Option 4: FULL MARKET

The Full Market option is based on the current proposals contained in the England & Wales Government's Water Bill for reforming the water industry. Currently, the Welsh Government is still deciding if the new legislation should be applicable in Wales.

In this option, all aspects of the water and sewerage supply would be open to competition from other water and sewerage companies. Business and non-domestic customers would be able to switch their customer service suppliers. The pipe networks and treatment centres connected to your property could be provided by a number of different companies, rather than the existing provider. The industry would still be regulated by Ofwat, albeit it with a 'lighter touch' after the market has developed.

**Page 7 - Diagram of Options**

The following diagram displays the options that were described on the previous page



## Page 8 - Rating the Options

We'd now like to know how you see each of the four potential alternative options in terms of how they might influence the aspects you rated earlier in your current provision of water and sewerage services:

- Product
- Price
- Customer Service
- Choice of Provider
- Environmental Service
- Availability, Reliability & Security

\* 11. For each Option, please rate on a scale of 1 - 10 (with 1 being Poor, and 10 Excellent), how you think it might affect the PRODUCT you receive.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Wales-Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory & Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market-Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

\* 12. For each Option, please rate on a scale of 1 - 10 (with 1 being Poor, and 10 Excellent), how you think it might affect the PRICE you would pay.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Wales-Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory & Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market-Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

\* 13. For each Option, please rate on a scale of 1 - 10 (with 1 being Poor, and 10 Excellent), how you think it might affect the CUSTOMER SERVICE you would receive.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Wales-Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory & Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 14. For each Option, please rate on a scale of 1 - 10 (with 1 being Poor, and 10 Excellent), how you think it might affect the CHOICE of provider you would have.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Wales-Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory & Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 15. For each Option, please rate on a scale of 1 - 10 (with 1 being Poor, and 10 Excellent), how you think it might affect the ENVIRONMENTAL activities of water and sewerage companies.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Wales-Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory & Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |



- \* 16. For each Option, please rate on a scale of 1 - 10 (with 1 being Poor, and 10 Excellent), how you think it might affect the RELIABILITY, AVAILABILITY & SECURITY of water supply and sewerage service you would receive.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Wales-Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory & Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

Thank you. The information provided from the questions you've just answered will help to inform an analysis of the options. Please now answer the next sets of questions to complete the survey, which will evaluate how important you think the Welsh Government Outcomes are for Water and Sewerage Provision, and how well the options may deliver them.

**Page 9 - Delivering Outcomes**

The following table outlines the Welsh Government Outcomes, and how that relates to water and sewerage provision.

Please take a moment to read the table, and then rate how important these Outcomes, in the context of water and sewerage provision, are to your organisation.

| Welsh Government Outcome        | Water & Sewerage Focus   |
|---------------------------------|--|
| Enhancing Our Environment       | <ul style="list-style-type: none"> <li>• Catchment Management</li> <li>• Wider Ecosystem Service Benefits</li> <li>• Renewable Energy</li> </ul>                         |
| Protecting People               | <ul style="list-style-type: none"> <li>• Flood Protection</li> <li>• Resilience</li> </ul>   |
| Supporting Enterprise and Jobs  | <ul style="list-style-type: none"> <li>• Infrastructure &amp; Capacity Planning</li> <li>• Shellfish Waters</li> <li>• Security of Supply</li> </ul>                     |
| Improving the Nation's Health   | <ul style="list-style-type: none"> <li>• Drinking Water Quality</li> <li>• Education</li> </ul>  |
| Viable and Vibrant Places       | <ul style="list-style-type: none"> <li>• Bathing Water Quality</li> <li>• River Water Quality</li> <li>• Sustainable Urban Drainage</li> </ul>                           |
| Delivering Social Justice       | <ul style="list-style-type: none"> <li>• Affordability</li> <li>• Bad Debt</li> <li>• Metering</li> <li>• Customer Service</li> </ul>                                    |
| Supporting Skills and Knowledge | <ul style="list-style-type: none"> <li>• Innovation &amp; New Technology</li> <li>• Apprenticeships &amp; Graduate schemes</li> <li>• University Partnerships</li> </ul> |

\* 17. Please rate on a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how important each one of these Outcomes are to your organisation, in the context of water and sewerage services.

|                               | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------------|---|---|---|---|---|---|---|---|---|----|
| Enhancing our Environment     | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Protecting People             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Supporting Jobs & Enterprise  | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Improving the Nation's Health | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Viable & Vibrant Places       | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Delivering Social Justice     | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Supporting Skills & Knowledge | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

Thank you.

The following page will ask you a final set of questions to evaluate how well you think the Regulatory and Legislative Options outlined earlier in the survey will deliver against each of these Outcomes.

**Page 10 - Evaluating Welsh Government Outcomes against the Options**

The following questions aim to gather your views on how well you think the current and four alternative options for

regulatory and legislative frameworks in the Water and Sewerage industry in Wales will deliver the Welsh Government Outcomes.

- \* 18. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome ENHANCING OUR ENVIRONMENT be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

- \* 19. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome PROTECTING PEOPLE be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

|             |   |   |   |   |   |   |   |   |   |   |
|-------------|---|---|---|---|---|---|---|---|---|---|
| Full Market | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
|-------------|---|---|---|---|---|---|---|---|---|---|

\* 20. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome SUPPORTING JOBS AND ENTERPRISE be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

\* 21. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome IMPROVING THE NATION'S HEALTH be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

|             |   |   |   |   |   |   |   |   |   |   |
|-------------|---|---|---|---|---|---|---|---|---|---|
| Full Market | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
|-------------|---|---|---|---|---|---|---|---|---|---|

\* 22. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome VIABLE AND VIBRANT PLACES be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

23. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome DELIVERING SOCIAL JUSTICE be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

\* 24. On a scale of 1 - 10 (with 1 being Poor, 10 Excellent), how well will the Outcome SUPPORTING SKILLS AND KNOWLEDGE be delivered by the Options.

|                         | 1 | 2 | 3 | 4 | 5 | 6 | 7 | 8 | 9 | 10 |
|-------------------------|---|---|---|---|---|---|---|---|---|----|
| Current                 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Wales Only Regulator    | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Regulatory + Incentives | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Market Lite             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |
| Full Market             | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0  |

**Page 11 - End**

## APPENDIX C

### Existing Evidence Base – Further Information

#### C1. Regulatory Reform

##### *New Ofwat regime*

Effects of the new Ofwat regime for the next price review period (2015-2020) are considered to be overall positive in relation to the Welsh Government outcomes. There is increased emphasis on companies “owning” their business plans and delivering outcomes supported by customers through much greater engagement with customers on their priorities and needs. Affordability of water services for low income groups is also given greater prominence. The total expenditure incentive regime is intended to support greater innovation and flexibility in achieving outcomes (e.g. catchment management solutions and partnership working).

##### *Water Bill*

The proposed reform of the Special Merger Regime may impact the balance of companies operating “wholly or mainly in Wales”. The possibility of a merger of a water company in Wales with one in England is not currently a material issue to be considered in the OFT/Ofwat first stage referral to the Competition Commission, with the focus on the impact on comparative regulation, rather than how it may alter the legislative regime and legal jurisdiction that a merged England and Wales water company could fall under. With diverging regulation in Wales and England, this could be an issue to be addressed.

Ofwat and DWI will continue to regulate across all England and Wales, but the NRW environmental jurisdiction is limited to the national borders of Wales only. CC Water will retain its distinct Welsh oversight within the broader CC Water England and Wales remit.

An amendment was tabled during the Report Stage of the Water Bill in the House of Commons to align the legislation along the national boundaries rather than water company boundaries. However, this was defeated, with the UK Government stating that “*it would not make changes to the devolution settlement in advance of the review and report by the Commission on Devolution in Wales*”.

##### *Cross-subsidy considerations*

Development of a competitive market for water services under the Water Bill may affect existing cross subsidies, with no clear cut ‘winners and losers’. Some existing cross subsidies within the water sector are beneficial and socially desirable (i.e. regionally averaged prices, social tariffs and bad debt recovery). However, other cross subsidies are untenable in a market (i.e. between low margin and high margin customers). Strong regulatory rules about the cost allocation between eligible and non-eligible customers need to be enforced, and the rationale behind unwinding cross-subsidies made transparent. This will be important in England and Wales with the regulatory separation of wholesale and retail water tariffs from 2015 onwards.

There is a need to ensure that market set-up and administrative costs are only recovered by those who benefit from competitive framework. There will need to be a clear rationale for allocating these market costs to eligible customers (i.e. the split between Welsh customers who consume greater than 50 million litres per year and all business customers in England and Scotland who will be eligible for retail competition).

#### C2. Other regulatory and market reform evidence

##### *Cave Review 2009*

Professor Martin Cave was commissioned by the UK and Welsh Governments to review competition and innovation in water markets in Wales and England.



Cave acknowledged that there were some benefits from the Dŵr Cymru Welsh Water business model and that this model could be *“potentially beneficial for other consumers if it were to be adopted elsewhere”*. These benefits included (at 2009): relative improvement in the overall performance assessment; limited increase in household bills compared to other water companies; high customer satisfaction in relative and absolute terms; growth in reserves (or “customer equity”). The review further acknowledged that there are different social, economic and political circumstances in Wales, including widespread public and political support for the Glas Cymru ‘not-for-profit’ model.

Nevertheless, Cave was *“not convinced that competition would undermine the benefits of such a model. Indeed I would expect competition to reaffirm them as customers would be able to choose Welsh Water as their preferred supplier”*. Cave also noted that Dŵr Cymru Welsh Water (at 2009) was a ‘follower’ in terms of research and development and that compliance with drinking water standards (at 2009) required improvement.

Cave did not recommend a “one-size-fits-all” approach and considered that *“some recommendations will be more applicable in some areas than others and should be taken forward accordingly”*. The UK Government accepted the Cave Review recommendations to reduce the threshold for non-household competition to five million litres per year in England, whilst the Welsh Assembly Government decided there was insufficient evidence to justify the threshold being lowered.

### **National Assembly for Wales: Environment and Sustainability Committee inquiry into water policy in Wales 2013**

This inquiry considered issues in relation to competition in the non-household market and water affordability. The latter issue was focused on household customers, with no views being expressed in relation to business customers.

The Committee considered evidence from water companies, regulators and heavy users of water in Wales. Key evidence presented included:

- Large water users would generally only consider switching suppliers if there were reductions in price of 10-15%. Any reduction in price should be not at the detriment of service.
- Dŵr Cymru Welsh Water did not consider that introduction of competition would be beneficial to customers. The costs of setting up the market system would be expensive and there is a risk of cost differences being passed on to household customers.
- Dŵr Cymru Welsh Water stated that it would be able to operate with a different retail regime in Herefordshire to that in Wales if required to do so.
- Severn Trent Water supports the principle of competition as it should reduce customer bills, and in particular drive environmental innovation, sustainability and customer service innovation. The company considers that lowering the threshold for non-household competition would stimulate the market.
- Severn Trent Water considers that changing legislative boundaries to match political boundaries for retail competition would increase costs, with potential impacts on customer bills.
- Dee Valley Water considers that the introduction of a specific Service Incentive Mechanism for business customers supplied by companies wholly or mainly in Wales will help drive continued improvement in service and price.
- Dee Valley Water expressed concern that non-household retail competition could lead to household customers subsidising non-household customers unless transparent protection is put in place from the outset.
- Dee Valley Water raised concern that the introduction of a different retail regime for companies operating wholly or mainly in England could lead to confusion for business customers.

- Ofwat believes that retail competition would deliver a range of positive benefits and that it had calculated that the potential benefit to Wales was *“in the order of £18m over 3 years”*.
- Ofwat agreed that, under retail competition for non-household customers, it would need to strongly monitor for any increase in costs for household customers by companies to balance any discounts being offered to business customers.
- CCWater raised concerns in respect of not introducing competition in Wales, including confusion for customers, particularly those in border areas or with sites in both England and Wales. It was also concerned that the businesses operating across sites in England and Wales would not see the full benefits of competition.
- CCWater consider that business customers generally would like choice of supplier, although this does not necessarily translate into customers actually switching their supplier.
- CCWater consider that retail competition could exert pressure on existing companies to improve their services but, equally, customers could be disappointed if the scale of any reduction in their water bill did not meet expectations.

### **“Silk Commission” review**

The Commission for Devolution in Wales (the “Silk Commission”) has recently (March 2014) published its report on devolved legislative powers in Wales, including a review of the implications of the Water Bill. The Commission:

- Considered that the *“presumption should be in favour of aligning respective competences with the geographic borders”* of England and Wales and that the *“legislative authority of UK Ministers over water undertakers in parts of Wales is anomalous”*.

- Raised concern that some citizens in England (customers of Dŵr Cymru Welsh Water and Dee Valley Water) are subject to Welsh legislation, *“something on which they have no representative voice”*.
- Concluded that *“the administrative boundary should define the limit of Welsh Government competence”*
- Considered there should be co-operation between the Welsh Government and UK Government such that *“the National Assembly and Welsh Government can make decisions on water inside Wales, and the UK Parliament and UK Government makes those decisions in respect of England, but that the interests of consumers are protected. A formal intergovernmental protocol on water would also be necessary to deal with any cross-border issues.”*
- Found no strong arguments put forward in evidence for retaining the status quo on sewerage legislation. It concluded *“that there is a strong case for powers relating to sewerage to be devolved”*.
- Reported that the anticipated costs of the boundary and sewerage proposals (subject to the outcome of further work on the practicalities of the boundary changes) *“should not involve material costs”* to water customers or taxpayers.

### **C3. Water Company Customer Research**

#### **Dee Valley Water Research**

Dee Valley Water has commissioned independent research which shows that its customers believe it is delivering a good service that represents good value for money. The company report that it achieves consistently high rankings in independent customer satisfaction surveys that are carried out every three months (Dee Valley Water, 2013).

Independent research for the company’s business plan development indicated that *“maintaining a consistent supply of wholesome water to customers that is good value for money”* is the most important priority. Additionally, business customers were keen for Dee Valley Water to

provide on-site leakage and water efficiency audits. Domestic and business customers were generally satisfied with the service provided but were keen to see some improvements in relation to supply and interruptions resilience, reduce discoloured water and leakage levels. Of secondary value to both domestic and business customers were reduced carbon emissions, reduced road disruptions and improved water efficiency messaging.

Domestic and business customers supported future improvements to the service even if it led to a moderate bill increase. However, customers also want “proper” long-term investment rather than ad-hoc repairs, so may be able to accept slightly higher bill increase in order to secure this for the next 5-year period (Consumer Challenge Panel report, 2013).

“Uninformed” acceptability of the draft Dee Valley Water Business Plan increase was very low for business customers at 21% (compared to 69% for household customers), but rose to 58% when the outcomes of the expenditure programme were provided to business customers (compared to 71% for household customers). Acceptability is however likely to be higher for the final Business Plan which proposed a lower level of price increase (Consumer Challenge Panel report, 2013).

### **Dŵr Cymru Welsh Water research**

Dŵr Cymru Welsh Water measures levels of satisfaction through independent research to obtain the views of 1,700 business customers who consume more than 5 million litres of water per year. This has recently been extended so that the views of the remaining 100,000 business customers are included in the research, helping the company refine and improve its services to meet customer requirements. Since 2011, there have been four surveys with satisfaction levels as follows:

- August 2011 - 85.20%
- February 2011 - 89%
- September 2012 – 87.60%

- May 2013 – 88.43% (enhanced survey of all business customers)

The company is aiming to improve satisfaction levels from the current average of 87% to 90% by 2020 (Dŵr Cymru Welsh Water, 2013).

Based on customer research, the company is focusing business customer service improvements on the following key areas (Dŵr Cymru Welsh Water, 2013):

- dedicated non-household customer team
- better communication and ensuring customers are kept informed of key developments
- single billing for multi-site organisations
- a “My Business Account” facility for non-household customers to manage their water account, update details and preferences
- web portal to support developers’ accessing all relevant information relating to their applications
- more dedicated customer relationship managers to deal with the largest commercial customers on an individual basis
- developing a widening portfolio of offerings including flexible account and tariff structures, and a new range of service offerings, including meter telemetry, leakage detection, water efficiency advice, trade effluent logging, process and treatment consultancy, surface urban drainage systems, discounts linked to payment methods and reduce and reuse facilities.

In addition, Dŵr Cymru Welsh Water has committed to ensuring that no customer in Wales is worse off as a result of the different retail market arrangements in England, and to monitor developments in the market in England to ensure the company is always competitive on customer service, value and innovation.

Independent research for Dŵr Cymru Welsh Water’s business plan development indicated that:

- both business and household customers would accept relatively small increases in bills for improved services that would deliver long-term environmental and service benefits
- the great majority did not favour any deterioration in services in return for a bill reduction, and did not wish to delay necessary investment
- there was support for proposed outcomes and the balance between investment and bills for ‘informed’ customers (i.e. those that had the Business Plan explained to them)
- only 52% of the ‘uninformed’ business customers (56% of household customers) supported the initial draft proposals which included an increase in water bills
- 17% of ‘informed’ respondents preferred bills to be reduced.
- Business customers who found the proposals unacceptable included a higher proportion of organisations employing fewer than 50 people and consuming less than five million litres of water per year

Testing of revised proposals for a 1% per year reduction in average bills (achieved through efficiency measures) showed a significant increase in approval from ‘informed’ business customers, rising to 95% overall (and 88% in relation to value for money). However, there was no testing of the revised plan proposals with ‘uninformed’ customers.

The research also indicated that when customers were informed of the Glas Cymru not-for-profit business model, they subsequently tended to be more supportive of Dŵr Cymru Welsh Water’s proposals.

### **Severn Trent Water research**

Customer research by Severn Trent Water for its Business Plan development did not highlight any specific differences between its business customers in Wales and the majority in England. Business customer engagement identified the following key priorities for the future (Severn Trent Water, 2013):

- Be easy to deal and interact with
- Resolve problems quickly and keep them updated
- Provide tariffs that are value for money
- Provide a single point of contact and service management
- Provide options to help lower effort and overheads
- Help reduce consumption and therefore costs.

## **C4. Water regulatory regime in other nation states**

### **Northern Ireland**

Northern Ireland Water has been established on similar lines to Scottish Water, but without any retail competition regime. Economic regulation of the water company is carried out by a combined utility regulator, covering water and energy. There are no current plans for introducing retail or wholesale competition.

### **Republic of Ireland**

Similar to Northern Ireland, a publicly-owned water company (Irish Water) is now being launched in the Republic of Ireland having initially been established as part of the national energy company (Bord Gais). The regulated company will remain the sole supplier of water in the country with no current plans for retail or wholesale competition. As in Northern Ireland, economic regulation of Irish Water is carried out by a combined energy and water economic regulatory body.

### **France**

Water provision in France is characterised by public-private partnerships similar to the situation in many states of the USA. Local municipalities partner with private, expert water supply companies, with competition materialising between these companies during the tendering process. Individual household or business customers do not have a choice of water supplier. This localised, decentralised regulatory model has been considered to provide a balanced approach between competition and

regulation, and achieving market-led infrastructure provision. However, the ‘market’ is effectively dominated by only three major private water companies, accounting for around 95% of water and sewerage services. It is also argued that decentralization has weakened economic and environmental regulation and diffused enforcement powers.

## Germany

The provision of water services in Germany is somewhat similar to France. Water supply and sewerage are the responsibility of local municipalities, which can contract out these services to independent providers. Unlike France, there is a very fragmented water sector, with a total of about 6,400 water supply utilities that operate under either private or public law. Prices are subject to ‘cost-plus’ tariff models and the German Federal Cartel Office supervise prices in the case of cross-border activities between different Lander.

## Netherlands

The performance of the 10 water supply companies in the Netherlands is monitored closely through compulsory benchmarking, which takes place every three years via a public review process. The benchmarking process aims to ‘name, reward and shame’ to place pressure on the companies to strive for improvement. The benchmarking is coordinated by VEWIN, the association of drinking water companies in the Netherlands, rather than through a formal economic regulatory authority. Business and household customers cannot switch suppliers.

The performance review process is considered to provide transparency and highlights best practice so that companies learn from each other. The model keeps the administrative burden at low level whilst still yielding efficiencies (according to a study by the Erasmus University in Rotterdam, water sector cost efficiency improved by 27.5% between 1997 and 2009).

## Belgium

Most of the municipalities of Belgium have delegated the responsibility for water supply and sanitation to some 62 regional or inter-municipal utilities. There is no competition regime in place.

## Sweden

The 290 municipalities are responsible for water and sewerage provision. As with many other European countries, the municipalities principally contract out the services to private or municipally-owned limited companies. The relationships between the municipalities and the companies are regulated by law. Water pricing is regulated by special legislation to protect consumers, but there is no competition or choice of supplier for customers.

## Other European states

Many other EU states are characterised by municipality models with a mix of public service provision or “concession contracts” to private suppliers on a monopoly service basis (e.g. Tallin in Estonia; Sofia in Bulgaria; various cities such as Barcelona in Spain). Competition and choice of supplier for public water and sewerage services by customers is not a feature of other European states; competition is between private suppliers and the contracts/concessions let by municipalities or local governments.

## C5. Experience from the UK electricity sector

Retail and wholesale competition across other utility sectors is well established in the UK. Energy and telecommunications customers have had choice of supplier since the 1980s. The stated benefits of competitive models usually focus on improving customer service, driving efficiencies in wholesale and retail costs and encouraging more innovative services. Competitive markets for utilities have been considered as a natural progression from privatised regulatory models.

## Electricity case study

The competitive electricity market was created in 1988 with legislation setting out a full market structure. A phased approach was adopted to the introduction of full competition in the retail and wholesale electricity markets, and associated ‘unbundling’ of the vertically integrated structure of the industry:

- generators
- high voltage national grid operator
- wholesale distributors (network operators)
- retailers

In 2002, all retail price controls were removed.

Initially, opening up of the retail market to both household and non-household customers in 1998 led to a ‘switch’ rate of 18%, which was within the range of switching rates for comparable markets. However, in more recent times, switching rates have fallen and the market now has a high proportion of “sticky” customers who are not switching retail suppliers.

After 15 years of competition, Ofgem conducted a ‘Retail Market Review’ during the past two years to address issues of:

- widespread consumer confusion over tariffs
- poor retailer behaviour and “pressure sales” tactics to encourage switching
- lack of transparency in charging
- overall decline in switching rate

In response, Ofgem’s regulatory approach has recently moved towards stronger regulation following its extensive review of the effectiveness of the market. Reforms have been recently introduced in order to:

- Reduce tariff complexity
- Ensure customers have easy access to key information to make informed choices

- Strengthen enforcement powers to fine suppliers for misconduct
- Require companies to meet a Standard of Conduct

In addition, there has been growing concern in the electricity generation market relating to future security of supply with a lack of long-term investment by generators. The UK Government has undertaken an ‘Energy Market Reform’ review to support the draft Energy Bill, setting out a range of measures for the generation market to ensure:

- Energy supply security for the UK
- Achievement of carbon reduction targets
- Greater encouragement of sustainable technologies
- Increased capital investment in infrastructure

## APPENDIX D Stakeholder Feedback Detailed Information

### D1. Current water and sewerage service provision

i) There is a general consensus across most stakeholders that the evolution of the existing legislation and regulatory regime since privatisation has delivered benefits for customers in terms of key service attribute. In particular, **efficiency improvements and efficient financing** have helped to deliver improved drinking water quality, supply resilience and environmental improvements at an **affordable price for the majority of business customers**.

ii) The combination of above inflation price rises coincident with the economic downturn since 2009 has more recently increased the pressure on some business customers in relation to their water bills. Nevertheless, for the majority of business customers, **water bills remain of lesser concern compared to other cost pressures, particularly business rates and energy bills**.

iii) There is a broad acknowledgement that incumbent water companies operating in Wales (as in England) have **not given enough focus and attention to the needs of business customers**, and that improvements can still be made. Customer service improvements by incumbents have mainly been driven through regulatory measures (e.g. Ofwat's Service Incentive Mechanism) rather than driven from engagement with business customers and understanding their needs and priorities. **Some stakeholders feel this is a reflection of the lack of competitive pressures in the water industry**.

iv) There is an explicit recognition amongst many stakeholders that the process of considering market and regulatory reform in England - and the proposed move away from the current framework - has, in itself, already started to **drive a greater focus on the quality and price of services** delivered to business customers.

v) Some stakeholders expressed very strong views that the **current arrangements for allowing competition for the provision of services to developers has not been as successful as it could be**. Regulatory and legislative barriers, along with existing incumbent behaviours (such as speed of response and procedures), were cited as hampering the development of improved services in this particular part of the sector.

vi) Uncertainty around regulatory and market reform in Wales, coupled with the economic downturn in the construction sector, are **limiting the commercial viability of further Inset Appointment opportunities** to provide greater competitive pressures on the incumbent water companies *within the existing regulatory framework*. Organisations that are interested in pursuing Inset Appointments feel the existing barriers are **limiting the scope for innovation in customer and environmental service** (for example, environmentally-sustainable sewerage management initiatives as an integral part of a new development or joint water-energy water efficiency solutions).

vii) Overall, most stakeholders expressed generally **good levels of satisfaction with their current service provision**. Nevertheless, most stakeholders felt that there was room for improvement – particularly in relation to:

- **Greater (and faster) engagement and communication** – especially at a technical level on operational matters
- Greater focus on **understanding and meeting business customer requirements**
- Greater level of **expert advice** to customers
- Improved **metering and on-line billing** services
- **Improve the processes for businesses to get connected to the water and sewerage network** – takes too long currently

viii) There is an acknowledged need for **greater co-operation between the multitude of organisations responsible for drainage and flooding**, including agreeing ownership and responsibilities for maintenance.

ix) Many business customers felt that there was a **need for greater flexibility and innovation in tariff structures**, and that the existing regulatory regime appeared to act as a barrier to water companies responding to business customers on tariffs.

## D2. Water company ownership models

There was generally **very strong support for the not-for-profit model of Glas Cymru** (owner of Dŵr Cymru Welsh Water). This extended beyond the financial structure, with a consensus view that the Glas Cymru model also supported **greater community engagement and involvement in wider environmental and social initiatives** than would be the case for a PLC or privately-owned water company. This includes the Glas Cymru independent “Members” that act in lieu of shareholders to provide challenge to the Board, and who are appointed to represent different socio-economic and environmental interests in Wales (although none are currently *specifically* appointed to represent business customer interests).

Many stakeholders expressed the view that opening up the water industry in Wales was not necessary because of the not-for-profit ownership structure of Glas Cymru. Some stakeholders went further to suggest that the **ownership model should apply to the whole of Wales**, and that this would be a far better option than any moves to follow the Scottish Water model and bring ownership under the government.

Some stakeholders commented that Dŵr Cymru Welsh Water is more able to respond to the investment needs preferred by customers, as the governance structure of the company requires much **greater public scrutiny and stakeholder involvement in its business planning process**. In addition, the financial structure of Glas Cymru allows **access to low cost capital funding** providing direct benefit to business customers in terms of **lower bills**.

However, there were some concerns expressed by others that the dominance of Dŵr Cymru Welsh Water, its access to relatively low cost finance and generally high level of customer support, **may mean that complacency sets in**. This in turn could lead to a lack of action on driving

out further efficiencies to ensure that water bills are kept as low as possible and competitive in comparison to other water companies. Dŵr Cymru Welsh Water’s performance in the Ofwat regulatory “league tables” for water bills, efficiency and environmental performance were cited as evidence that the **ownership model does not translate to high levels of efficiency and environmental performance**. Conversely, others felt that there was significant pressure on Dŵr Cymru Welsh Water from the Glas Cymru Board and members to drive efficiencies and further improve service to **demonstrate that the model does work for customers**.

A small number of stakeholders also raised the issue that there is a **perception of ‘regulatory’ capture** as Dŵr Cymru Welsh Water may be seen as an “extension” of the Welsh Government and that there is not sufficient “clear water” between the policy maker and the company. A further concern expressed related to a perception that the not-for-profit model of Glas Cymru was seen by policy makers as the “answer” to delivering for business customers in Wales, whereas the **financial structure and ownership model does not, in itself, deliver improvements** in service sought by business customers.

## D3. Proposed regulatory reforms

There was a general good level of understanding across stakeholders of regulatory reform measures proposed by Ofwat, contained in the Water Bill or in consultation documents (e.g. on abstraction licence reform). Concern was expressed by some stakeholders that the decision by the Welsh Government not to extend retail competition in Wales may **perpetuate behaviours that act to stifle competition** in those areas that are already open to competition (e.g. new connections and Inset Appointments/NAVs). In addition, a significant number of business customers expressed **concern that business customers in Wales will not receive the same price and service benefits** that may arise for customers who will become eligible to switch suppliers in England.



Conversely, others expressed the view that **retention of the 50MI threshold in Wales could result in better customer service offerings for non-household customers**, as there will be considerable pressure and scrutiny on Welsh companies to demonstrate that competition is not necessary to drive customer service improvements and efficiency savings. The view that Wales could essentially be in a “competition” with England and Scotland as to the respective benefits of the different regulatory models was raised by several stakeholders as a **positive force for encouraging improved service for customers in Wales**. There were conflicting views on whether there was a strong “pull” from business customers in Wales to lower the threshold in line with England and whether sewerage services in Wales should be open for retail competition, at least in relation to the 50 MI threshold for water supply.

Concern was expressed by some stakeholders that there is a **risk of water companies in Wales being “left behind”** the development of the retail market. If, at a later date, the Welsh Government decides to exercise its powers to introduce greater retail competition, the Welsh companies would not have the benefit of experience and capabilities of retail organisations operating in England and Scotland. For example, Welsh companies are not currently involved in the “Open Water” Programme that is working on the operational details of the retail market in England. However, it was also pointed out that if the Silk Commission recommendations are taken forward, the Welsh companies *will* need to acquire these capabilities to compete in their operational areas within England.

The evolution of the specific **Ofwat ‘Service Incentive Mechanism’ (SIM) relating to business customers** for water companies operating “wholly or mainly” in Wales was evidenced by several stakeholders as providing sufficient incentives to water companies to improve customer service, which is the key priority for business customers. Ofwat consulted on the changes to the SIM in October 2013. Some stakeholders have responded to Ofwat suggesting further strengthening of the proposals, including retaining comparison with metrics on the performance of English water

companies in relation to business customers and increasing the level of reward/penalty associated with the incentive.

Some stakeholders felt that the costs of market set up and management for increased retail competition in England would cancel out or even outweigh the benefits to customers, recognising the relatively small margins involved and consequent scale of price reduction. Uncertainties in both costs and benefits were cited by others as making it difficult to determine whether introducing retail competition would be worthwhile.

There was **widespread support for the ‘Outcomes Delivery Incentive’ (ODI)** approach being introduced by Ofwat from 2015. This reform encourages water companies to more explicitly link performance to customer and environmental outcomes identified from customer research, engagement and feedback. This should help to driver **greater flexibility and innovative approaches** in the delivery of water and sewerage services. Some stakeholders referenced the specific ODI proposed by Dŵr Cymru Welsh Water (2013) in its Business Plan submission to Ofwat relating to customer satisfaction score target for all non-household customers. Dee Valley Water has not proposed a similar ODI.

Benefits associated with Ofwat’s **water trading incentive** for business customers were less clear, but many stakeholders expressed the view that water companies in Wales should ensure that the **true value of any water exported to England is reflected in the export price** and that the income benefits should be reflected in lower water bills.

Overall, regardless of the differing views on regulatory reform, there was **broad support for the Welsh Government taking powers in the Water Bill that allow Wales to make its own decisions** on the future regulation of water companies operating “wholly or mainly” in Wales. This included support for **legislative powers for sewerage to also be devolved**, which was seen as an anomaly given that it represents around 50% of the total water bill.

## Inset Appointments

There was support from several stakeholders for **improvements to the Inset Appointment/NAV process** aimed at reducing barriers; however, there was also **concern that the “devil is in the detail”** and the required supporting regulatory changes (devolved to Welsh Government) may miss the opportunity for real reform for inset appointments/NAVs (as distinct from “retail” competition). **Encouragement for further inset appointments in Wales was viewed by some as an important feature of the regulatory regime** in the absence of wider competition, placing some competitive pressures on the incumbent water companies and helping to drive innovation for new developments in particular. Developers feel they are not valued as customers, that they are not adequately engaged by incumbents to help drive innovation in new developments, and that there are too many delays and barriers for new connections. Although the number of complaints from developers has reduced in recent times, more still needs to be done to improve levels of service.

Companies pursuing the inset appointment model considered that there were still too many barriers being placed in the way of inset applications, hindering the business model. They also emphasised the added value benefits that they believed could be achieved through inset appointments, including:

- Integrated services for water, sewerage, drainage and energy
- Innovation in new development design, working with developers from the outset, such as sustainable drainage systems, high water efficiency standards, rainwater harvesting and novel sewage treatment solutions
- Added value services for business customers, such as sub-metering, leak detection, water recycling advice, combined energy and water efficiency process improvements.

Most stakeholders considered that inset appointments would exert a degree of reputational and financial pressure on existing water

companies to improve service to customers and to developers. However, with only two inset appointments in Wales to date, there is very little evidence on which to confirm these pressures have directly led to improvement action by the incumbents.

Conversely, several concerns were raised by some stakeholders in relation to the inset appointment/NAV regime:

- The number of challenges and disputes in England and Wales shows that further reform is required.
- NAVs may have different objectives and pressures compared to incumbents, such as a focus on “bundled” water and energy services, enabling lower returns on water services to be offset by returns on energy services.
- Developers are likely to be more focused on reducing cost rather than future customer service.
- Differentially lower costs exist for maintaining new infrastructure within an inset new development (and hence enabling higher margins for the NAV). If there are more insets, the incumbent will have an increased proportion of ageing infrastructure to maintain, leading to upward pressure on bills for customers of the incumbent (effectively subsidising the inset appointment).
- Insets within the Dŵr Cymru Welsh Water footprint lead to profits flowing to the NAV shareholders rather than to Glas Cymru for re-investment under the ‘not-for-profit’ model.
- Risk that appointees will walk away once the assets start to deteriorate and require maintenance investment.
- Confusion for customers as to who they should contact if there are water or sewerage service failures or problems.

Some of these concerns were raised in relation to the application for the inset appointment by SSE Water at Llanilid Park, but were not seen as sufficiently significant by either Ofwat or the High Court (following a legal challenge by Dŵr Cymru Welsh Water).

## D4. Welsh Government policy and strategy

Most stakeholders welcomed the overall policy direction of the Welsh Government for natural resources management in Wales, and the integration of environmental, social and economic considerations. Most stakeholders also agreed that Wales should have its own water strategy that focuses on the specific needs and challenges for water and sewerage provision in Wales. However, many stakeholders were keen to ensure that if there are policy differences between Wales and England, that they provide **additional** benefits to customers in Wales compared to adopting the English water regulatory regime – and clearly explain the benefits.

In considering the not-for-profit model of Glas Cymru, and the small number of companies operating “wholly or partly” in Wales, several stakeholders raised the possibility that **an independent economic regulatory approach for Wales could be considered**, particularly given the widening divergence in adopted legislation between England and Wales. As Ofwat increasingly has to regulate two different water and sewerage retail markets, several stakeholders viewed this as an opportunity to create an independent economic water regulator for Wales, in the same way that Natural Resources Wales has been established for water environmental regulation. In this way, Welsh Government would have direct influence over the guidance it gives to the economic regulator. A number of stakeholders felt this **might be further extended to a joint water and energy economic regulator for Wales** in line with the Northern Ireland model. However, others questioned the costs of setting up and running a separate economic regulator and felt that Ofwat was more than capable of regulating two different retail markets. Although there are differences in relation to competition, the **vast majority of the regulatory regime remains common to both Wales and England**.

Some stakeholders also raised the possibility of **extending the Glas Cymru model to the whole of Wales** to ensure all customers in Wales received their water and sewerage provision from a not-for-profit

company. A single water and sewerage company for Wales was seen as a more efficient vehicle for **integrated delivery of improvements**, rather than the current, more fragmented delivery across several companies. Other stakeholders held a very different view, advocating that **improved customer service and efficiencies would be better achieved by greater competition** within Wales as some companies operating wholly or mainly in Wales were seen to be performing relatively poorly against Ofwat’s existing efficiency assessments. Several stakeholders expressed the view that, if competition is not increased, Welsh Government should strengthen the regulatory regime to incentivise the incumbent water companies to improve customer service and deliver greater efficiencies – the **proposed Ofwat regulatory changes were seen as too weak in the absence of competitive pressures**.

In developing the water strategy for Wales, many stakeholders felt that it was **important to ensure that business customers operating in rural communities were better supported and not disadvantaged** by any changes to the regulatory regime. Access to the public water and sewerage network was cited by several stakeholders as an important element in sustainable growth of the rural economy. Concern was also expressed that increased competition would lead to “cherry picking” of customers in urban areas, placing business customers in rural areas at risk of increased water bills.

### Welsh Government outcomes

Business customers were broadly supportive of the Welsh Government’s outcomes for natural resources management. Overall, there was greatest support for the following outcomes:

- Enhancing our environment
- Viable and vibrant places
- Protecting people

These three outcomes were considered to particularly **support sustainable economic growth**, which in turn will benefit businesses operating in Wales. Local authorities emphasised the links between

resilient infrastructure provision, addressing surface water flooding and environmental enhancement in **supporting inward investment and new development**. Representatives of the tourism industry were particularly supportive of water companies having a greater remit to enhance the environment, working in partnership with other organisations to help **grow tourism in Wales**. Industrial companies were keen to ensure access to **reliable infrastructure to support their growth** and for their premises to be protected from flooding. Agricultural and rural land management bodies were interested in the **pursuing partnership working** with water companies and **developing market-based instruments** (including payments for ecosystem services) to deliver environmental improvements.

Stakeholders generally agreed that the outcomes provided a sound basis for the development of the water strategy and that integrating social, environmental and economic objectives would benefit businesses in Wales. Some concerns were raised that perhaps the environmental outcomes carried a higher weighting than social and economic outcomes, and that care needs to be taken to **ensure water company customers are not cross-subsidising other sectors** through more integrated, partnership working approaches.

The creation of the **Wales Water Industry Forum** was referenced by many stakeholders as a constructive vehicle for promoting sustainable water concepts and bringing the relevant parties together to develop integrated solutions, as well as engaging with water companies on their business plan submissions to Ofwat.

## D5. Other utility experiences

In seeking views on water and sewerage provision, many stakeholders raised issues in relation to experiences from other utility services, particularly energy and telecommunications. Concerns were expressed by a significant number of respondents about recent developments in the energy sector, with consolidation of the number of retailers leading to a

perceived lack of choice and reduced price competitiveness. In turn, this raised concerns that retail competition for water and sewerage may suffer the same issues in the medium term.

Others raised concerns at the lack of investment in the wholesale energy market (generators and distributors) following a focus on short-term price control rather than taking a longer-term view. There was a “read across” to wholesale competition for water, with the risk of short-term approaches being taken to remain competitive reducing investment in resilient water and sewerage services and hindering partnership working with local government, landowners and NGOs.

A number of stakeholders raised the issue of innovation and the approach taken by Ofgem to incentivise energy companies through its Innovation Funding Initiative.

Rural businesses and community groups raised **concerns relating to the provision of telecommunications infrastructure (mobile and broadband) in rural areas**, and the fact that access was more limited than in urban areas. There was a concern that similar issues could arise if a more competitive regime was introduced into the water sector. As already referenced, rural businesses would like to see greater access to water and sewerage infrastructure.

Other stakeholders cited the **customer service and tariff choice benefits of competition in the telecommunications sector**, which are both areas where business customers would like to see improvements in relation to water and sewerage provision.

The **disaggregation of the vertical supply chain** in other utilities was referenced by many stakeholders and the **effect of this on communications and speed of response** when problems arise or service changes are needed. Many business customers expressed frustration at not being able to get through to the right technical expertise on first contact and being passed between the retailer, wholesaler and contractors. Concern was therefore expressed that disaggregation of the water industry vertical supply chain may lead to difficulties when

problems, such as a drinking water quality issue or sewer flooding, occur. **Responsibilities may be blurred, leading to a slower and less well co-ordinated response.**

## D6. Wales-England border issues

Most stakeholders referenced the **need for clarity** as to the application of English or Welsh legislation on water competition. There was consensus that **improved information and communication for businesses**, particularly those in “border” areas, is essential so that customers are not confused about eligibility (as has happened in Scotland for small companies). The risk of confusion will increase with the extension of competition in England to sewerage services, particularly for customers with different water and sewerage providers. Those expressing a preference stated that it would be **preferable for the legislative boundary to follow the political boundary** of Wales rather than, as now, dependent on which water Company is providing the service. In this way, business customers are better able to use democratic processes to seek changes or modifications to the regulatory regime through their elected representatives. This preference to address the “democratic deficit” is in line with the Silk Commission recommendations..

If the Silk Commission recommendations are taken forward, the two Welsh water companies and Severn Trent Water will need to manage two different business customer retail operations, with the risk of additional regulatory and administrative costs. **This would affect around 10,000 business customers.** This includes Ofwat regulating separate business customer retail margins for those customers in England compared to Wales. Companies may also potentially need to operate to different guidance on access pricing dependent on whether the Welsh Government and Defra provide different guidance for the replacement of the current legislative “Cost Principle” approach.

**Changes to the operating boundaries of water companies were considered to be of a much lower priority than other needs and requirements of business customers**, particularly as the greater majority

of businesses in Wales are supplied by a water company “wholly or mainly” in Wales and only at one single premises.

Stakeholders also recognised that the **costs of amending water company boundaries were likely to be prohibitive** given the integrated nature of assets and natural river catchment boundaries. It was therefore far more cost-effective to retain water Company operating boundaries but apply the competition legislation according to where the customer is located (i.e. according to the political boundary).

The **vast majority of business customers did not consider that having a different retail regime in Wales to England was of particular concern.** Cross-UK and multi-national businesses are already used to different legislation applying in the different nations of the UK as well as globally. Some stakeholders however were concerned that a “**postcode**” lottery may arise, with businesses on one side of the border benefiting from better service or reduced bills, whilst those on the other side were not able to avail themselves of the same benefits.

A further issue was raised by some customers with a number of sites across England and Wales. One of the benefits and drivers for introducing competition has been cited as the ability for customers to manage water and sewerage bills and services for a number of geographically disperse sites through one retail company, in order to reduce administration costs and improve customer service. However, with differences between England and Wales, concern was raised that **‘single bills’ will not be possible for companies who have sites in Wales and England.** Others suggested that operational arrangements could be made by the Welsh companies with the retail companies in England to ensure customers do receive a single bill and that this required co-operation rather than regulation.

Whilst it was suggested that the effect on the monetary benefits would be marginal for those business customers having to deal with water and sewerage providers in Wales separately from those in England, the

**reputational and political effects for the water industry (and governments) may be more significant.**

Of greater importance to stakeholders, however, was the need to ensure that **businesses operating in Wales are not put at any disadvantage** from the Welsh regime compared to England, and ideally that the decisions in Wales provides a positive benefit to businesses. If not, then the need for a different regime in Wales would be questioned by many stakeholders. Most stakeholders did not wish to see a different regime in Wales merely to emphasise the different constitutional arrangements.

Some customer representative stakeholders expressed concern that business customers **may feel penalised by not having access to competition** on account of their physical location. Strong, clear communication with customers on the eligibility rules for competition in Wales is therefore seen as critical.

In terms of the creation of new licences in England, but not Wales, the operation of different regulatory and legislative framework across the border was highlighted as **potentially acting as a barrier to further development of this component of the water sector in Wales.**

From a water company perspective, **working with different environmental regulatory bodies across England and Wales (Natural Resources Wales and Environment Agency/Natural England) is not seen as inhibitory**, although there is the potential for different decisions being made on the same water catchment/river basin. Any moves towards separate economic, consumer or drinking water quality regulators for Wales would also carry similar risks. If this were to occur, the geographical boundaries of their responsibilities should follow those of Natural Resources Wales to ensure a consistent and joined-up regulatory framework.