



Consultation under Section 13 of the Water Industry Act 1991 on proposed modification to condition B of Anglian Water Services', Severn Trent Water's and South West Water's licences.

1. Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales.
- 1.2 We welcome the opportunity to comment on Ofwat's consultation on modifying the licences for Anglian Water (ANG), Severn Trent Water (SVT) and South West Water (SWW) to allow 'in period' revenue adjustments during a price control. This is intended to accommodate financial rewards and/or penalties achieved by the companies through specific areas of performance relating to Outcome Delivery Incentives (ODIs).

2. Background

- 2.1 We note that Ofwat's Final Determinations allow the three companies to adjust revenue 'in period' should financial rewards and penalties be incurred relating to a range of specific outcome performance commitments¹.
- 2.2 For SWW and SVT, this applies to a range of wholesale service commitments (eight specific commitments for SVT, seven for SWW), while for ANG the availability of 'in period' revenue adjustments relates to the ODI on leakage (three year average) only. With one exception (SWW's target for drinking water quality contacts) we are satisfied that the incentivised targets for these companies reflects 'upper quartile' performance, when compared across industry.

3. Examining company performance

- 3.1 We also note that Ofwat propose to "*examine each company's performance against specific commitments*" before determining whether there should be a revenue adjustment. This will be assessed by the December before this takes effect on customers' bills in the following April. We expect the data under examination will be shared with CCWater and other relevant parties, and where appropriate our views sought. We welcome Ofwat's statement that it will publish reasons behind such a determination.

4. Impact on customers

- 4.1 If a revenue adjustment is justified by robust performance data, consideration must be given to how this may affect companies' wholesale tariffs. It could mean that the revenue adjustment(s) affects different customer groups in different ways. We have a role in working with all companies on the setting of tariffs in their Charges Schemes. We will work with ANG and SVT in looking at how revenue adjustments are applied to wholesale tariffs, and the customer impact this may have. SWW's WaterShare panel provides a platform for looking at the revenue adjustments incurred by ODIs and how they will be applied, albeit in the context of the company's pledge to limit bill increases to less than RPI per year (see section 6 below).

¹ As listed in paragraph A 2.2.3 in each of the three company's Final Determination annexes, published by Ofwat - <http://www.ofwat.gov.uk/pricereview/pr14/finaldet>

5. Communicating with customers

- 5.1 It is important that, should rewards be applied and customers' bills increase, companies explain fully to customers why additional revenue has been allowed, and what they are getting in return in terms of improved service performance.
- 5.2 This is because, our research (as summarised in our responses to the draft determinations in October 2014²) shows that customers may react negatively if:
- in addition to RPI increases to their bills, they have to pay rewards for service improvements or outcomes that many would expect a company to deliver as a matter of course; and/or
 - the level of performance that achieves a reward is not reflective of upper-quartile performance.
- 5.3 Similarly, if penalties are incurred and revenue is reduced, companies should tell customers about the areas of service where they have performed poorly and the actions they are taking to address this, and over what timescale.
- 5.4 We would wish to see the three companies, with Ofwat's support, commit to communicating with customers in fully transparent and readily understandable ways using a variety of methods.

6. Sharing outperformance

- 6.1 In our response to SWW's draft determination³, we stated that the company's ODI targets should reflect 'upper quartile' service performance. Due to the 'enhanced' status awarded to SWW's business plan by Ofwat, a 'do no harm' principle was applied, which meant that Ofwat did not intervene and alter the ODI targets in SWW's final determination. Consequently, SWW's performance commitments for drinking water taste, smell and colour contacts do not reflect the industry 'upper quartile'. This means the company could achieve a reward against this measure for a lower level of performance than other companies would need to achieve.
- 6.2 Additionally, SWW has achieved financial benefits through its reward for an 'enhanced' status business plan and a higher cost of capital compared to the allowance set for the non-enhanced companies. However, we note the pledge by SWW's Board to limit average bill increases to less than RPI each year, thus limiting the impact of reward-driven revenue adjustments and any other financial gains the company achieves. We welcome this pledge as a way of limiting customer bill instability and sharing future success with customers.
- 6.3 SWW is proposing to establish a WaterShare panel to advise it on how best to share outperformance gains. As with any body that may affect regulatory decisions or the prices and services of monopoly water company customers, the panel will need to be fully independent of the company and be seen to be so by customers and other observers.
- 6.4 It is proposed that the WaterShare panel will influence decisions on the sharing of outperformance gains between customers (or particular customer groups) or benefits to the wider environment. Hence there will need to be sound governance

² <http://www.ccwater.org.uk/waterissues/pr14/consultationresponsespr14/>

³ <http://www.ccwater.org.uk/wp-content/uploads/2014/10/water-submission-.pdf>

checks and balances around his panel and its activities need to be fully transparent. It will need to be seen as legitimate when under scrutiny from customers and other potentially critical commentators.

- 6.5 We will work with the company on the development of the panel's remit and governance, in order to promote a good governance structure for the panel. It will also be important to establish principles around the sharing of outperformance between customers and the environment. In our role as the statutory independent water consumer body, we will observe closely the activities of the panel when it is set up. The same would apply should other companies wish to establish similar panels.

Enquiries

Enquiries about this consultation response and requests for further information should be addressed to:

Steve Hobbs
Senior Policy Manager
Consumer Council for Water
Tel: 0777 817 5006
E-mail: steven.hobbs@ccwater.org.uk