



Ofwat: Draft 2020-25 Price Control Determination for South West Water

CCWATER RESPONSE

MAY 2019

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. We welcome the opportunity to respond to Ofwat's 2020-2025 Draft Determination for South West Water (SWW).
- 1.2. The Draft Determination, and SWW's Business Plan, covers the two supply areas served by the company following its acquisition of Bournemouth Water in 2015. In its original supply area (principally Devon and Cornwall) SWW provides water and sewerage services, while in Bournemouth it delivers only water services.

2. Summary

- 2.1. *Acceptability Research:* CCWater commissioned DJS Research to carry out interviews with a representative sample of 500 customers from each water and sewerage company to test the acceptability of Ofwat's Draft Determinations. 85% of SWW customers in Devon and Cornwall and 93% of Bournemouth customers surveyed found the proposals acceptable (uninformed acceptability based on bill change from 2020 - 2025), indicating a high level of acceptability from customers. Further details on our research can be found in section 3 below.
- 2.2. It should be noted that this level of acceptability includes an assumption that the current £50 Government contribution to SWW's household customers will continue, and is a factor in why the level of acceptability was so high. We'd like to see the £50 contribution clearly explained in Ofwat's Final Determination.
- 2.3. *Affordability:* We are encouraged to see progress being made to support customers who are struggling to pay. However, we believe companies still need to do more to deliver the step-change that is required. Across the industry there will still be more than 1 million customers who are in need of assistance who will not be receiving it, even after the improvements companies are making.

- 2.4. Our [Water Matters research](#) (2017) found that 61% of SWW customers in Devon and Cornwall and 82% in Bournemouth found their charges affordable. We are pleased to see that the company has made stretching commitments to tackle the issue of affordability - such as aiming to double the number of customers receiving help through social tariffs to 50,000 by 2024-25, and that all customers should find bills affordable by 2024-25.
- 2.5. *Vulnerability*: CCWater believes that in order to get a good picture of how a company is performing in providing services for customers in vulnerable circumstances they must measure awareness of the help that is available and satisfaction with the service being provided. We are pleased that Ofwat has introduced a common Performance Commitment in this area, something CCWater called for in our response to the PR19 methodology. We feel that there should be more focus on identifying and delivering support to customers in transient circumstances (i.e. consumers who find themselves in vulnerable circumstances unexpectedly and/or temporarily). Raising awareness of the support available so that customers know what help they can access - and how they can access it - is crucial.
- 2.6. We believe there is the potential that a target which focuses solely on numbers could drive the wrong behaviours, such as a focus on increasing numbers on the register without considering the quality of support provided. We will be monitoring companies' activities in this area closely to see which customers are being signed up for the Priority Service Register (PSR), for what services, and whether the help being offered is meaningful.
- 2.7. *Outcome Delivery Incentives (ODIs)*: We would like to see companies demonstrate a commitment to deliver exceptional performance and clear customer support for both the principle and range of ODI payments before they are included in plans or price determinations. We remain concerned about the potential for ODI outperformance payments to have a significant impact on customer bills and lead to a potentially negative customer reaction.

2.8. We note that Ofwat has increased the stretch in some key Performance Commitments proposed by SWW and strengthened some ODI underperformance payments. We support these changes, which SWW has accepted, as they will favour customers and help reduce the potential negative impact on bills, and bill profiles.

2.9. *Customer Experience measure (C-MeX)*: We welcome the clarity on the details of the shadow reporting of C-MeX which will inform its final design and will monitor how this progresses. We remain concerned that there may be insufficient weighting given to a company's complaints performance so that they may be able to achieve a financial reward even where their complaints performance is poor or worsening.

2.9 *Cost of capital*: We believe it may be possible for Ofwat to set an even lower Weighted Average Cost of Capital (WACC), thus delivering further bill reductions. An independent study commissioned by CCWater¹ has recommended a range for the WACC between 1.7% to 2.3%², based on an analysis of water company financing, market evidence and capital financing assumptions in other regulated sectors. This is slightly lower than the estimate that was calculated by the same consultants, ECA, back in December 2017 in its first assessment for CCWater.

2.8 ECA's range also falls below the initial view of 2.4% that Ofwat announced during the winter of 2017/18, a figure that will already ensure the average bill for 2020 to 2025 is between £15 and £25 lower than at the previous price review in 2014.

2.9 However, if Ofwat were to adopt ECA's recommendations it could lead to customers being better off by between £1 to £14 more. We would like to see Ofwat reduce the WACC further as evidence shows this is feasible and will benefit customers.

¹ Update to our recommendations for the Cost of Capital 2020-25 (Economic Consulting Associates for CCWater, January 2019) – see [here](#).

² Real (RPI) WACC appointee level

2.10 *Isles of Scilly (IoS)*. The Draft Determination includes an allowance of costs associated with SWW becoming the licensed water and wastewater company for the IoS. While CCWater recognises the financial and environmental drivers behind this Government-led initiative and accept that this is the best solution, the residents of the IoS will see the benefit of a transfer of infrastructure to SWW but this will be at the expense of higher bills to SWW's existing customers. This cost is not insubstantial and CCWater has pressed SWW to show that its customers have been adequately informed and engaged on the proposal and that they have established its acceptability with customers.

3. Customer acceptability

- 3.1. Our DD research found that a high proportion of SWW customers think that the Draft Determination proposals are acceptable. 86% of uninformed customers and 83% of informed customers said the plan was either “acceptable” or “very acceptable.” SWW customers in Bournemouth also found the plans acceptable overall. 93% of uninformed customers said the plans were “acceptable” or “very acceptable”. However, while 91% of informed water-only customers said the plans were acceptable, this fell to 78% when combined with the sewerage bill.
- 3.2. More than a fifth of SWW customers did not believe that the potential changes to their bills that could occur due to the impact of ODIs were acceptable, while more than 1 in 10 customers didn’t know. Nearly a quarter (23%) of Bournemouth customers believed that the impact of ODIs was unacceptable and this rose to a half of all Bournemouth customers surveyed when they were asked to consider their sewerage bills. This highlights the potential for there to be a significant customer backlash against the impact of ODIs on bills once this is fully realised.
- 3.3. These top line findings give an indication of customers’ feelings about the Draft Determination. The full report, which will explore in more detail the reasons behind these answers, will be published on our website:
<https://www.ccwater.org.uk/research/category/price-reviews/>

4. Bill profile and cost efficiency

- 4.1. The Draft Determination would see bills reduce by 15% in real terms over the period 2020-25, which is a greater reduction than that proposed by SWW in its Business Plan. This greater reduction in bills reflects SWW’s acceptance of Ofwat’s view on efficient costs. However, we are disappointed that Ofwat has chosen to publish an aggregate average bill covering both operating areas covered by SWW. This does not allow visibility of forecast bills in both areas which SWW’s Plan does. These figures do not include inflation and the impact of ODIs, so we expect the company and Ofwat to make this clear to customers when explaining bill impacts at Final Determination and beyond.

- 4.2. The Draft Determination also does not include reference to the impact of a continuation (or otherwise) of the annual Government contribution of £50 to household customers in SWW's main operating area. The continuation of this contribution was crucial in determining the high level of customer acceptability for SWW's Plan. We'd like to see the £50 contribution clearly explained in Ofwat's Final Determination.
- 4.3. The bill profile put forward in the company's plan reflects customers' preference that bill reductions should be passed on quickly, but that this should not result in bill volatility. The plan, and the Draft Determination, therefore allow for an immediate reduction in 2020-21 followed by a smooth real-terms reduction to 2025. We are happy that this reflects SWW's evidence of customers' preferences and that SWW's WaterShare+ mechanism will continue to protect customers from bill volatility.
- 4.4 SWW has committed to continue its WaterShare scheme, as WaterShare+, through which it will mitigate the potential impact of unexpectedly good performance resulting in a higher level of ODI outperformance payments. The company is also proposing a one-off share issue to customers to reflect outperformance against ODIs in the current price control period.
- 4.5 While we welcome the commitment to share outperformance to benefit customers, there is uncertainty around what level of benefit this would deliver as outperformance generally (not just ODI rewards) can be affected by several factors, such as the rate of inflation. We intend to work with the company to monitor performance and look at to what extent the benefits these mechanisms provide relate to the level of outperformance.

4.6 Furthermore, while the outperformance sharing protects customers from excessive ODI rewards, the use of the incentives still creates a degree of bill uncertainty for customers. SWW's evidence shows that customers prefer stability.

5. Safe, reliable services: maintenance and long-term investment (including water resource investment where appropriate)

5.1. SWW's plan appears to address the priority resilience issues for current and future customers. However, we cannot be sure that it has identified and highlighted all of the risks.

5.2. Resilience can be affected by factors that may be uncertain or unforeseen now but may affect the company's ability to deliver its services reliably and securely in the future. Therefore, we wish to see companies showing flexibility to adapt to changes to current and future risks, and demonstrating to their customers and stakeholders that they have done so.

5.3 In the Draft Determination, SWW has committed to provide to Ofwat an action plan on their systems-based approach to resilience in the round by 22nd August. Ofwat has asked SWW to *'ensure that the company can demonstrate in the future an integrated resilience framework that underpins the company's operations and future plans showing a line of sight between risks to resilience, planned mitigations, package of outcomes and corporate governance'*.

5.4 We look forward to seeing more detail on the company's response to this challenge and to work with them as they develop this framework. We would also like to hear from Ofwat about the interventions it would propose to make if SWW's action plan was viewed as sub-standard.

6. Outcomes - Performance Commitments and Outcome Delivery Incentives

- 6.1. Overall we consider the package of Performance Commitments and ODIs set out in Ofwat's Draft Determination for SWW is stretching, in line with customer priorities and reflect the evidence of customers' views established through the extensive engagement SWW carried out during the development of its Business Plan. These reflect changes made in response to the Initial Assessment of Plans (IAP) and agreed by SWW. We particularly welcome the strengthening of commitments on environmental performance which is a key area of improvement for SWW, and important to customers.
- 6.2. However, customer research evidence shows that customers have concerns about the principle of companies receiving financial rewards for delivering services, and the impact this might have on bills. While we welcome the steps Ofwat has taken to moderate the potential bill impacts which might result from ODI outperformance, we consider that there remains a potential for bill levels to be significantly higher than those that will be set out in Ofwat's Final Determination as a result of the ODI mechanism, and that customers may react negatively in response to this.
- 6.3. We welcome SWW's commitment to continuing its WaterShare scheme, its proposal for a share issue as a way of sharing its outperformance successes in the current price control period, and the other steps it is taking in response to Ofwat's position statement 'Putting the sector back in balance'. While the company's gearing is projected to remain below 70%, SWW has given a clear undertaking to implement the default gearing benefit mechanism should it rise above this level.

6.4. As mentioned above, the level of future outperformance is uncertain and can be affected by several factors. As any sharing mechanisms should deliver benefits to customers that are relative to the level of outperformance, we would like to see the company review these sharing mechanisms if the level of outperformance turns out to be greater than envisaged now.

7. Affordability & Vulnerability

7.1. We welcome the package of commitments SWW has proposed to help address affordability and vulnerability in its area in addition to the overall bill reduction proposed for 2020-25. The company has committed to;

- Double the number of customers on support tariffs to 50,000.
- Increase its social tariff cross-subsidy from £2 to £9 and jointly fund an extension to its WaterCare scheme.
- Continue household income maximisation checks.
- Provide dual billing for unmetered customers to show the potential benefits of switching.
- Improve customers' views of value for money.
- Reduce the number of customers in water poverty - 100% finding bills affordable by 2025.
- As per the new Ofwat requirement, increase the number of customers on its Priority Services Register (PSR) to >7% by household by 2024-25 and to check the details of 100% of customers on the PSR every two years.

7.2. There is a potential that a target to increase numbers on priority services drives the wrong behaviours and we want to ensure that help is meaningful for customers. We will be closely monitoring the types of customers (e.g. household, residents in care homes, hospices, prisons and hospitals) on the scheme and what help customers are signing up for. We will also liaise with companies to understand which customers who would benefit from being on the PSR may be missing out and how they can be reached.

- 7.3. Ensuring companies hold accurate and relevant data is essential and is a requirement of GDPR. Customers would therefore expect that companies check the accuracy of data and that customers are receiving the support they need as a matter of course.
- 7.4. Part of Ofwat's vulnerability PC requires companies to contact 90% of customers on the PSR every two years. Clarity is also needed on what "contact" means. Does it involve interaction from both parties e.g. the customer and the company? If so, this is a difficult target to achieve - response to contact to check data in energy is around 50%. Will it be necessary for the checks to be done on those with enduring needs? Will companies be able to use an opt-out approach e.g. a text, e-mail or letter saying if we don't hear from you we will assume your needs remain the same?
- 7.5. Whilst priority service registers are effective in recording the additional support needed by customers experiencing longer term vulnerability, more needs to be done to help customers who find themselves in "transient vulnerability". Many customers who do not consider themselves to be in vulnerable circumstances can find that this changes overnight. This was a key learning point from the recent freeze-thaw incident which saw thousands of customers who may not consider themselves vulnerable placed in circumstances where they required assistance but did not know where to go for it.
- 7.6. We feel that customers receiving the support and/or their representatives are in the best position to feed back on whether the help is meaningful and there should be more focus on establishing and measuring this. To support this, a measure of customer satisfaction with services provided would be of benefit.
- 7.7. Our DD research found that only 48% of SWW customers thought their current charges were affordable, with more than a quarter (27%) stating that they found them unaffordable. The number of customers who considered their bill to be affordable increased to 66% of customers when asked about SWW's bill proposal for 2020 - 2025.

7.8. This evidence shows there is still a significant number of customers who may struggle to pay, which highlights why SWW's affordability commitments are needed and why further financing efficiencies (such as a potential reduction in the cost of capital) may lead to additional bill reduction at Final Determinations without reducing the company's commitments to its customers.

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