The voice for water consumers
Y corff sy'n rhoi llais i ddefnyddwyr dŵr

CCW's response to the Competition and Markets Authority's Provisional Determinations for Anglian Water, Bristol Water, Northumbrian Water and Yorkshire Water

Date: 27 October 2020

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1. Introduction

1.1 The Consumer Council for Water (CCW) is the statutory consumer organisation representing household and non-household water and sewerage consumers in England and Wales. We welcome the opportunity to submit our views to the Competition and Markets Authority (CMA) on its Provisional Determinations for the four companies that appealed their 2020-25 Final Determinations by Ofwat.

2. Executive Summary

2.1 The CMA's Provisional Determinations are a significant change for customers compared to the package of prices, investment and service commitments proposed in Ofwat's Final Determinations in 2019.

2.2 Interim changes to price control settlements in the past have led to uncertainty in the sector; uncertainty not just regarding this price review period but also the next. This cannot be a distraction from delivering the existing important priorities for customers.

2.3 While customers would approve the increased investment allowed for improvements to areas of service they value – such as leakage reduction and increasing resilience against future risks such as climate change – this comes in a package that proposes bill increases before inflation at a time when many customers will be under pressure financially. We are concerned that the increase in the assumption of the cost of capital that drives these increases goes against recent regulatory precedent and runs the risk of being over generous to companies at the expense of customers.

2.4 While the CMA took account of evidence of customers' views in terms of the additional resilience investment allowed for in the Provisional Determinations, there is no evidence that the impact on customers was considered in terms of the overall increase in financing costs and prices.

<u>Bills and customer affordability</u>

2.5 The CMA proposes bill increases before inflation of £6 (Bristol), £12 (Northumbrian) and £14 (Anglian, Yorkshire) compared to Ofwat's Final Determinations, which on average delivered a bill reduction. The Provisional Determinations' lack of year-on-year bill profiles for 2021-22 to 2024-25 is a concern, as it does not allow customers to understand how the decisions made by the CMA will affect them in practical terms. For example, we would not want any back-end or front-end loading of bill profiles, as evidence from many companies' research shows customers prefer a 'smoother' bill profile.

2.6 This lack of transparency over the real impact on customers' bills will add to customers' worries at an extremely uncertain time. We are very concerned about the affordability of these increases given the potential impact of Covid-19. These bill increases, coupled with annual inflation, could be a tipping point for some households.

Evidence of customers' views in decision making

2.7 The 2019 price review (and the one preceding it) has seen an increase in both the volume and quality of companies' customer engagement, so we must ensure that customers continue to have their say.

2.8 It is hard at times to understand how the customer voice has been taken into account in the CMA's provisional findings. Customer research is only one component of ensuring the customer voice is heard, and while evidence of company best practice in this area is mixed, the general direction of travel and the need to amplify the customer voice should not be diminished. Just because there are limitations in the extent to which evidence from customer research drives decisions, evidence of customers' wider opinions of value for money, affordability and their perspective of fairness and trust in the sector should not be disregarded.

2.9 While customers' views have been considered in individual company responses - in particular with regard to specific investment proposals on resilience, we question how the consumer voice has been taken into account in the round. The cost of capital increase drives nearly all the bill increases for customers. It appears there was no consideration in this decision of customer affordability, or the potential for customers to find such an increase unacceptable at a time when many customers are under financial pressure

Cost of capital

2.10 It is clear from our annual tracker surveys that the fairness and value for money of water bills are areas where consumer sentiment is lower than it should be. The CMA's decision on the Weighted Average Cost of Capital (WaCC), which appears to tip the balance in favour of shareholders over customers, doesn't appear to have considered the potentially damaging impact on this from the consumer perspective.

2.11 The CMA's provisional findings (increasing WaCC from 2.97% to 3.49%[1]) skews the risk/reward package firmly in companies' favour at customers' expense, and appears generous to companies compared to capital financing decisions in other regulated sectors. This carries a risk of significant outperformance by companies (as seen in the past when the

[1] Vanilla (pre-tax cost of debt and post-tax cost of equity)

cost of capital was higher). If the cost of capital increase is removed, overall changes in the 'package' for customers would be minor.

2.12 The CMA has also allowed an increased small company allowance (0.1% on the WaCC) for Bristol Water. While this is lower than the 0.3% the company asked for, we are disappointed that consideration has not been given to the additional benefits customers should receive in return for this uplift, following the CMA's rejection of Ofwat's 'evidential' test.

2.13 We are disappointed with removal of the gearing outperformance sharing mechanism, which would have seen customers get a share of future outperformance. The removal of this mechanism, without any alternative being proposed, removes protection for consumers. When coupled with the changes to the WaCC, the financial metrics have tipped the balance in favour of investors.

Additional totex allowances

2.14 Customers support the investment in key projects, and like any investment, they want to see what they get in return in order to have confidence that the investment will mean projects are delivered in a responsible and sustainable way. We therefore question why Yorkshire Water has received significant additional funds for leakage reduction but not an enhanced Performance Commitment target.

2.15 The CMA has allowed extra base allowances for Anglian Water and Bristol Water to reflect higher costs of their frontier leakage reduction performance. As the CMA has removed the enhanced ODI rewards available for leakage, we support this allowance to keep leakage reduction down (as it is a customer priority) and remove the risk of bill instability caused by higher ODI rewards.

Resilience investment

2.16 Notwithstanding our wider concern about how evidence of customer opinion was considered in the round, we are satisfied that the CMA took account of customer evidence when deciding to allow additional resilience investment and (as per our submission in May) that it also evaluated technical evidence and costs alongside this. We support the additional resilience investment allowance, as customer support for these programmes is robust.

Performance Commitments (PCs)

2.17 The over-reliance on the simplistic PC measure of numbers listed on a Priority Services Register misses two key points; the vital importance of overall awareness of the help that's available (and not just for currently vulnerable customers - as Covid has highlighted the transient nature of vulnerability), and the effectiveness of the support that's given.

2.18 We also consider that the CMA's Final Determination is an opportunity to introduce further commonly applied reputational ODIs to track the number of customers in water poverty, and their satisfaction with the assistance they receive from companies. At a time when customer affordability is under greater strain, such measures may help incentivise companies to improve.

3. Bills & Customer Affordability

Bill increases

3.1 The Provisional Determinations propose bill increases before inflation of £6 (Bristol), £12 (Northumbrian) and £14 (Anglian, Yorkshire) compared to Ofwat's Final Determinations. CCW is very concerned about the affordability of these increases for customers given the wider economic context. While the financial support that companies can offer customers who are struggling to pay lies outside the scope of the CMA's Determinations, the increase in bills caused by the Determinations is very much in scope.

3.2 Our written submission to the CMA in May 2020 highlights the high level of customer acceptability for the average bills proposed in Ofwat's Draft Determinations. It is reasonable to assume that the average bills in Ofwat's Final Determinations would have had a similar level of customer acceptability, given there were only minor differences.

3.3 The bill increases in the CMA's Provisional Determinations, added to annual inflation, may not be so acceptable to such a number of customers, at a time when the economic consequences of the Covid-19 pandemic will be putting increased strain on many households. We are aware that for many customers, even a small bill increase can lead to affordability problems.

3.4 The CMA should consider the affordability of its Determinations for customers as, even with the growth in companies' financial assistance for customers in 2020-25, there will still be more than 1 million households in need of assistance who will not receive support, even before the economic impacts of the Covid-19 pandemic are fully seen.

Bill profile

3.5 With any regulatory price determination, it is important to show customers clearly the changes they can expect to see to their bills every year. Water companies' customer research in this price review (and earlier ones) consistently showed that customers prefer a smooth profile to any bill increases rather than experiencing spikes in any one year.

3.6 The CMA's Provisional Determinations do not include all the technical steps required to convert its decisions into changes to regulatory price controls. We would ask that when this is completed for the CMA's Final Determinations, the impact of each Determination on customers' bills is shown on a year-by-year basis (rather than an average change). We also ask the CMA to ensure that the bill profiles are appropriately smoothed to match customers' expectations and so help customers with their budgeting.

Customer affordability and vulnerability

3.7 The Provisional Determination says that the CMA has been mindful of the issue of vulnerable customers - both the financially vulnerable who may face difficulties affording bills and those who are vulnerable for other reasons. It also states that most of the measures offered to address customer vulnerability issues (Priority Service Registers and Social Tariffs) lie outside the scope of the PR19 price control but where relevant they have given these careful attention.

3.8 We accept that debt repayments and financial support falls out of the price control and that it is for companies to work with regulators, customers, CCW and other organisations to ensure the support is appropriate.

3.9 However, there is an opportunity for the CMA in its Final Determination to expand the scope of the current common Performance Commitments (PCs) to improve the incentives on companies to engage customers further in order to improve their evidence of the level of water poverty, and how effectively companies are assisting customers in this situation.

3.10 CCW would like to see more commonly applied PC measures and incentives to cover:

- Customers' views of the affordability of their bills.
- Customers lifted out of water poverty by support.
- Company contributions to funding affordability assistance.

3.11 If companies are commonly tracking customers' views and the number of customers in water poverty, they will have better and more consistent data to help target the more vulnerable groups of customers that need support. As progress with delivering PCs is subject to Executive and Board scrutiny within water companies, this may also raise the issue to greater prominence on company agendas.

3.12 While the CMA welcomes the common Performance Commitment (PCs) linked to vulnerable customers that encourages companies to identify those most likely to need additional support, these measures only focus on increasing the numbers registered for priority services and checking that the data on the register is correct.

3.13 Work is already underway between the energy and water industries to look for opportunities to share data. However, we feel the common PCs do not go far enough and there is a missed opportunity to address transient vulnerability, to deliver accessible services for all, and ensure any support offered is meaningful. To tackle these challenges, we recommend that the following PCs should be included:

- Companies to raise awareness of the support available through their priority services registers to 60% by the end of 2025. Currently awareness is at 42% and more needs to be done to ensure that **all** customers are aware of the support that is available should they need it.

- Companies to have 95% customer satisfaction (across all customers) that the companies' services meet their needs and are accessible.

- Companies to have 95% of customers who are on the priority services register satisfied with the support offered. Customers themselves are best placed to say if the support offered is meaningful.

3.14 We think that PCs relating to vulnerability and affordability should be reputational, as companies should not be financially rewarded for simply doing the right thing. The CMA should take the opportunity to expand on the common PCs to address these customer affordability and vulnerability issues in its Final Determinations, as we suggest.

4. Use of Customer Evidence in the Provisional Determinations

4.1 Customer engagement is important and must be used to inform decision-making in company business plans and regulatory determinations, but it has to be done in the right way to elicit meaningful and credible responses. The evidence from customer research and engagement has to be part of a robust and transparent triangulation process that weighs up other sources of evidence of customers' views and expectations. This reflects the conclusions of our Better Engagement research, which evaluated how to make research and engagement more meaningful for customers[2].

4.2 In this context, we support the additional investment to improve the resilience of water and wastewater services for the longer term in the Determinations for Anglian Water, Yorkshire Water and Northumbrian Water. Our written submission to the CMA explained how the customer support for this investment was credible in terms of how this evidence was gathered and interpreted.

4.3 CCW recognises that, while evidence of customers' views and expectations should have a strong weighting in decisions to increase investment or service delivery performance, there should also be a strong technical case to justify what the company is seeking to achieve. The decision to exclude Northumbrian Water's additional resilience investment relating to sewer flooding in the North East demonstrates that, while evidence of customer support may be robust, such investment cannot go forward if the technical and cost justification is weak. We

[2] CCW's recently published PR19 Lessons Learned report came to similar conclusions to the CMA on the use of customer research, identifying many positive improvements at PR19 but also recognising the need to refine the methods by which customers are engaged to ensure they can provide meaningful answers to the questions they are being asked.

welcome the CMA's 'second opinion' when reviewing the technical evidence for all of the disputed resilience investment in the companies' appeals.

4.4 However, while we support the consideration of customer evidence in these investment and service delivery decisions, as highlighted in section 3 (bills and affordability), evidence from our acceptability testing of Ofwat's Draft Determinations shows that customers may not support the bill increases proposed in the CMA's Provisional Determinations. Well-established evidence of customers' views of value for money, affordability, trust and fairness have not been considered more widely in terms of the overall effect on customers of the 'package' in the Provisional Determinations.

5. Cost of Capital and Gainshare Mechanism

5.1 We are very concerned with CMA's estimation of the Weighted Average Cost of Capital (WaCC), increasing the WaCC from 2.97% in Ofwat's Final Determinations to 3.49%[3]. This is a significant driver of the overall change in average bills between Ofwat's Final Determination and the CMA's provisional view. We do not see that it is merited and are concerned about the regulatory precedent which some of the methodological changes could set for future price reviews across water and other sectors, and the implications this would have for customers' bills in the long-term.

5.2 Against a backdrop of historic outperformance in the sector, we are concerned that the impact of the CMA's provisional WaCC will be used to benefit investors rather than improve financial resilience and/or benefit customers through additional investment. We do not think the CMA has struck the right balance between customers and investors in this regard and will be looking for the CMA to redress this balance in its final findings.

5.3 The WaCC from the CMA's provisional findings is significantly higher than the top of the range suggested by our consultants, ECA (finalised January 2019). This is particularly true of the cost of equity. On some of the CAPM parameters, the CMA's provisional findings on water seem manifestly different to its final determination in the NERL[4] case in July 2020. We do not see how the CMA can conclude significantly different estimates, and approaches, in such a short space of time.

5.4 Coupled with this, the CMA's determination indicates that its provisional findings lower companies' risk exposure relative to Ofwat's Final Determinations. Against this backdrop, a significant uplift to the WaCC seems perverse, particularly as 13 companies have accepted the WaCC set by Ofwat.

5.5 We have some specific observations on some of the individual elements making up the WaCC:

[3] Vanilla (pre-tax cost of debt and post-tax cost of equity)
[4] National Air Traffic Services (NATS) En-route Limited Price Determination by the Competition and Markets Authority, provisional findings March 2020 see here

5.6 **Total Market Return (TMR)**. The midpoint the CMA has used in its water provisional findings (6.95%; real CPIH) is higher than the top end of the range for the TMR in the NERL case (6.94%). The magnitude of this change since the NERL final report in July 2020 is so significant as to make us question the level of the TMR. Regardless of this, the CMA has chosen a spot rate for the TMR that is significantly above the midpoint of its range. We would like the CMA to reconsider its approach to TMR.

5.7 **Risk Free Rate (RFR).** We note that the CMA has moved away from regulatory precedent where the RFR was set by reference to government index-linked gilts merely using this as a lower bound for the RFR. We also note that the CMA appears to give significantly more weight to very highly rated non-government yields. This is at odds with the CMA's NERL assessment, which looked at a variety of ILG[5] maturities/spot rates and averages. We believe the CMA has put too much emphasis on non-government yields.

5.8 **Equity beta**. We do not support the CMA's estimate of equity beta. It is inconsistent with regulatory precedent and at odds with previous CMA determinations. We find such a high estimate of beta implausible given the relatively low levels of risk in water. We urge the CMA to review beta in its final report.

5.9 There is very little difference between the equity beta used in the NERL final report[6] (estimated midpoint 0.79) and that used in the water provisional findings (0.76). In the NERL case, the CMA considered, and discounted, using water as lower bound for beta citing significantly more volume/revenue risk for NERL than water companies. The CMA also concluded that, with regard to utilities, "*NERL was exposed to additional risks that were likely to imply a materially higher beta than those comparators*".

5.10 In the NERL case, the CMA found that "*removing the need to re-gear comparator data allowed the most accurate assessment of NERL's beta*". It is therefore questionable why the CMA has re-levered in the case of water, which takes the calculated beta higher than that observed in the market. We think that beta should be based on observed market data with no re-levering.

5.11 Our consultant's range[7] for beta was 0.55-0.65 – based on observed beta (using various beta calculations and a small upward adjustment in recognition of uncertainty of whether observed or "re-geared" betas should be used)

5.12 **Embedded debt.** We do not support the CMA's estimate for embedded debt. The bottom of the CMA's range of 4.82%-5.23% (nominal) is higher than 13 companies report their nominal interest costs to be in their 2019-20 annual performance reports. Of the appellant companies,

[5] Index Linked Gilts
[6] https://assets.publishing.service.gov.uk/media/5f350e17e90e0732e0f31c2a/NATS_CAA_final_report_for_publication_August_2020_-----.pdf
[7] https://www.ccwater.org.uk/wp-content/uploads/2019/04/Update-to-ECA-recommendations-for-the-Cost-of-Capital-2020-2025.pdf

all but Yorkshire Water have lower nominal interest costs than the implied nominal interest in the CMA's WaCC. If the CMA persists with its embedded debt assumption, it will go beyond cost-pass through, with customers in effect paying a premium above incurred costs (and this assumes that those costs were incurred efficiently). This effectively builds in financing outperformance at the outset, which is most likely to benefit investors. This is manifestly not in the customer interest and we urge the CMA to reconsider.

5.13 We note the CMA's argument that the use of shorter lookbacks could provide an inappropriate signal to companies that the regulator is encouraging them to shorten the tenor of their debt in order to reduce costs, potentially trading lower short-term costs for increased financing risk. However, there is a risk that with the precedent of locking in longer tenor of debt, coupled with an expectation on the back of the CMA's provisional findings of a premium on the cost of embedded debt, that it significantly lessens the incentive for prudent financial management. This would not be in customers' interests at subsequent price reviews.

5.14 **Financeability.** We note that the CMA has assessed that it does not need to adjust PAYG or run-off rates to secure the financeability of the four companies. As we noted in our initial submission, Ofwat used financeability levers for 12 of the 17 companies in its Final Determination. We are concerned that in setting the WaCC so high it could boost companies' financial metrics above and beyond those modelled in Ofwat's Final Determinations to the cost of the customer.

5.15 **Small company premium (SCP)** The Provisional Determination allows Bristol Water an uplift of 0.1% on embedded debt as a small company premium. This is lower than the 0.38% requested by the company and the 0.33% included by Ofwat in the WaCC for Portsmouth Water and South Staffs Water.

5.16 We do not believe that Bristol Water, or any company, should receive a SCP in the absence of value added to offset the impact on bills and would like the CMA to reverse its decision on this. This would look perverse to customers and would fail to incentivise Bristol Water, and other small companies, to find ways of adding value or of mitigating any additional costs caused by their scale. We are disappointed that the CMA has discounted Ofwat's benefits test in giving this allowance. However, we support the CMA's conclusion that an uplift on equity is not warranted for Bristol Water.

Gearing Outperformance Sharing Mechanism (GOSM)

5.17 We are disappointed that the CMA has removed Ofwat's GOSM from its provisional findings. This is especially the case as the CMA acknowledges that Ofwat has legitimate concerns that customers may face costs where the water companies have gearing well above notional levels, and this increase in gearing could have an adverse effect on financial resilience.

5.18 While we recognise that the CMA has misgivings about the GOSM, it would be more in customers' interests for the CMA to find a viable alternative that addressed the adverse impacts on financial resilience rather than simply removing an added layer of customer protection.

5.19 For our part, we remain supportive of the sharing mechanism. As we explained during our oral hearing, there has been evidence in the past of companies gearing up and providing higher equity returns to their shareholders. This view is supported by Ofwat's submissions to the CMA, which demonstrate that investors have withdrawn a significant amount of equity[8].

5.20 Based on 2019-20 gearing, six companies had gearing over the 74% threshold at which point Ofwat's gearing sharing mechanism would kick in in 2020-21. By virtue of companies' reported gearing and debt in the 2015-20 price control period, we estimate that the customer benefit of GOSM would have been over £450m over the price control period had the mechanism been introduced at PR14.

5.21 The mechanism proposed by Ofwat does not compel companies to reduce gearing. Rather it provides an additional incentive for companies to consider the customer interest when they take decisions on financial structure and financial resilience. In our view, this can only be a good thing.

5.22 The CMA's decision would remove any customer share of the benefit of higher gearing and remove any additional incentive for companies to lower gearing, increase financial resilience or consider the customer interest on financing decisions. This is not in the customer interest. This is another aspect of the Provisional Determinations where we struggle to see how the CMA has taken the consumer perspective/customer voice into account.

6 Totex, Cost Sharing Incentives and Efficiency Challenge

6.1 In our May 2020 submission to the CMA, we stated that, '*Delivering investments efficiently is something consumers expect their company to be doing. It is right for Ofwat to apply a strong efficiency challenge on consumers' behalf. If the CMA concludes that Ofwat's approach to efficiency is sound, and investment in resilience would not be delayed, then customers' views suggest that the Final Determination should not change*'.

6.2 In the main, the CMA has followed the same methodology as Ofwat for setting base and enhancement totex and applying an efficiency challenge. However, there are some adjustments applied by the CMA, which appear to move the risk/reward balance to favour companies, with potential detriment to customers.

Sharing rates.

[8] https://assets.publishing.service.gov.uk/media/5eb16056e90e0723aef8056c/008_-_Reference_to_the_PR19_final_determinations_Risk_and_return__response_to_common_issues__002_.pdf

6.3 We disagree with the CMA's departure from Ofwat's totex cost sharing rates. Taken in isolation, and in the round, we do not consider the CMA's approach to be in customers' interests because:

- It will increase bills in 2020-25
- It will reduce the incentive for companies to provide accurate business plan information.

We urge the CMA to review its approach on totex sharing in its final findings.

6.4 Part of the CMA's rationale for a more symmetrical approach is that there is a theoretical risk that companies could submit unattainably low totex estimates in order to secure more favourable sharing rates. However, in its provisional findings the CMA acknowledges that it did not find any evidence of this. As such, this does not seem a valid reason to change approach.

6.5 We accept that companies should pursue sustainable lower whole life cost options that provide an effective solution with value for money. However, we do not agree that Ofwat's approach on sharing rates discourages this - particularly for enhancement schemes spanning price control periods. We are concerned that adjusting sharing rates on this basis lowers the incentive for companies to provide a robust business case for proposed enhancement schemes.

Catch-up

6.6 We are disappointed that the CMA has reduced the catch-up efficiency targets by 0.7% for wholesale water and 1% for wholesale wastewater. The implication of the CMA's decision is that companies will find it easier to outperform on totex as a result of a lower efficiency challenge while reducing the customer share of that outperformance through the totex sharing mechanism. We do not see how this is in the customers' interests.

7 Leakage

7.1 CCW agrees with the CMA's view that companies should be able to deliver a substantial improvement in leakage reduction and that regulatory determinations should provide for '*ambitious action to reduce leakage.*" This is consistent with evidence of customers' expectations, as shown in companies' research.

7.2 As a consequence, the CMA accepts Ofwat's 15% leakage reduction target in the commonly applied PC, as the CMA has "*not seen evidence to suggest that there are better alternatives available to determine leakage targets for AMP7*."

7.3 The CMA states there will be a cost associated with a 15% reduction in leakage, as this is a step change in expectations[9]. The CMA accepts that costs of reducing leakage rise as leakage levels get lower. As a result, the Provisional Determinations allow Anglian Water and Bristol Water an adjustment to their base totex allowances to reflect their performance above the upper quartile[10].

7.4 We accept this adjustment as customers view leakage reduction as a high priority, as shown in companies' research. Maintaining or exceeding these targets could also lead to a higher upper quartile target for all companies in the future.

7.5 We also agree with the removal of the 'enhanced' ODI for leakage reduction. This means that while customers may slightly pay more for companies to meet their leakage commitments, the possibility of customers paying a higher amount for a company's 'reward' later (should they exceed targets) is removed.

7.6 However, we have concerns with the additional allowance for Yorkshire Water. We think there is a case for customers to benefit from an improvement in the company's leakage reduction, especially in light of the additional enhancement totex allowance of £93m, which currently would see customers pay more with no increase in the company's performance.

7.7 We think that the target should be increased, in line with Yorkshire Water customers' views when the company's business plan was developed, to challenge the company to reach the upper quartile. Without an improvement in performance, Yorkshire Water customers could be paying more for a company that may remain within the poorer performing companies in leakage reduction.

7.8 In our initial submission to the CMA, we highlighted that the company had reacted to its customers' dismay over its poor performance on leakage by committing to achieve a 40% reduction by 2025. This was subsequently scaled back to 25% and then 15% when Yorkshire Water discovered that Ofwat was unwilling to grant it substantial additional funding to pay for these reductions.

7.9 Yorkshire Water is a poor performer on leakage. CCW's 2018-19 Water Mark assessment saw the company rated 'Poor' and Ofwat's Service and Delivery Report 2018-19 identified the

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[9] *"Not sufficient evidence to disallow non-upper quartile performers from recovering the costs of achieving leakage performance"* (8.62)

"We will review the information provided to assess whether it provides sufficient confidence that the level of expenditure proposed will be in customers' interests." (8.67)

[10] We note that no adjustment has been applied to Northumbrian Water's allowance or target.

company (along with Thames Water and Southern Water) as offsetting the gains in leakage made by the rest of the industry as a result of its poor performance.

7.10 The CMA has suggested that Yorkshire Water's leakage performance is related to its targets not being challenging under the SELL methodology because of the company's water resource situation. We are not convinced that this is a compelling argument to explain the company's stagnant performance over the past ten years.

7.11 CCW is not in a position to judge whether an enhancement allowance is required to fund companies' leakage targets. However, we have some concern with the CMA's stated position that, "*companies that require enhancement funding should be allowed it, regardless of current performance relative to other companies"* (8.64)

7.12 Since it committed to achieving a 40% reduction by 2025 in December 2017, Yorkshire Water has managed to deliver a reduction of almost 10% (from 300M/L a day in 2018 to 271M/L a day in 2020). This would indicate that the company is able to deliver significant reductions within its current base cost allowance.

7.13 The CMA has acknowledged that the *"base cost allowance is sufficient to allow all companies to move towards upper quartile performance"* (8.44) so we are unclear why Yorkshire Water, which remains well below the upper quartile of performance, should be granted additional enhancement funding in order to improve.

7.14 If the CMA concludes, following its planned re-examination of companies' enhancement expenditure requests, that this investment should be allowed, then CCW believes that companies whose current performance is below upper quartile should be required to make improvements above the 15% industry baseline.

8. Performance Commitments & Outcome Delivery Incentives

8.1 The Provisional Determinations do not depart significantly from the Performance Commitments (PCs) and Outcome Delivery Incentives (ODIs) Ofwat set in its Final Determinations. In addition to our concerns about the leakage reduction PCs explained in Section 7 above, there are some adjustments the CMA has applied, where we have further comments.

Pollution Incidents/Sewer flooding

8.2 We are pleased that the CMA agrees with our belief that "*the nature of pollution incidents mean that customers would reasonably have concerns in paying rewards to companies for avoiding them*"(7.143). In view of this, we think the CMA could go further in removing or limiting outperformance payments for pollution incidents.

8.3 We support the interventions on Yorkshire Water's penalty collar for its sewer flooding ODI, and the re-setting of the penalty collar for Anglian Water's pollution incidents ODI. This will help provide a stronger incentive for the companies to improve and to deliver additional protections for customers.

Mains Repairs

8.4 We welcome the CMA's decision to include a deadband for the Mains Repairs PC. In CCW's response to Ofwat's Draft Determinations, we highlighted concerns raised by some companies about the potential for the PCs for Mains Repairs and Leakage to work against each other. The inclusion of a deadband to allow companies to carry out a limited number of proactive mains repairs without penalty is a sensible compromise solution to this problem.

9. Company-specific comments

9.1 In this section, we comment on specific adjustments or allowances for the four companies, not covered in the preceding sections.

Anglian Water

9.2 As CCW said in its initial submission to the CMA, Anglian Water's research showed customers opted in favour of the company making investments to improve the quality and resilience of services and environmental outcomes, rather than seeing bills fall. The inclusion of the additional investment proposed in the Provisional Determination would therefore be acceptable to customers.

9.3 Leakage is clearly a customer priority and Anglian Water's customers wanted it to remain frontier. However, if Anglian Water fails to achieve the improvements it is being funded for, customers should gain recompense. It is therefore essential that the ODI proposed by CMA remains in its Final Determination.

9.4 Given the uncertainty over how the ban of metaldehyde products will impact Anglian Water's plans, we would support a decision to pro-rata this allowance. At the very least, we think that the proposed claw back arrangement must be in place as a protection mechanism for customers.

Bristol Water

9.5 The CMA has proposed little or no change to the majority of Bristol Water's Performance Commitments and associated ODIs. We support the adjustment proposed for the company's leakage commitment, with an increase in base allowance coupled with the removal of an enhanced ODI outperformance payment. This will encourage leakage reduction – which is a customer priority – while mitigating the risk of bill instability caused by high ODI rates.

9.6 We also agree it is sensible to recalibrate the ODI rates relating to Per Capita Consumption (PCC). This reflects the overlap between this PC and that for meter penetration, and customer research, which suggested the rates set by Ofwat were too high.

9.7 The Provisional Determination also allows in full Bristol Water's cost adjustment claim relating to abstraction from the Gloucester & Sharpness canal. These costs are still not finalised and we are disappointed that the CMA's proposal transfers the risk to customers, when the company was protected through the 'notified item' process in Ofwat's Final Determination.

Northumbrian Water

9.8 We accept the CMA's decision not to include enhancement funding for the North East sewer flooding resilience programme, as there was unconvincing technical evidence to support it, rather than lack of customer support. As with the Ofwat Final Determination, the CMA believes Northumbrian's base costs allow for proactive sewer flooding risk reduction, and we will look to the company to deliver these commitments for customers. We agree with the CMA that given this, it would, on balance, be inappropriate for the company to have a bespoke ODI for this programme.

9.9 We support the inclusion of the Essex and Suffolk water resource resilience programme, as customers supported further resilience measures around water resources. The company also had a recent operational issue that suggested a potential risk to supplying customers without this programme in place. We note the CMA's statement that this was a finely-balanced decision and the company's case made it "*difficult for us to perform any form of cost benefit analysis*". We support the efficiency challenge that the CMA has applied to this scheme.

Yorkshire Water

9.10 We asked the CMA to consider the appropriate costs required to deliver the flooding alleviation scheme for the people of Hull and its surrounding areas. We welcome the CMA's intervention in this area, in particular the scheme-specific ODI that will protect customers against non-delivery of the improvements that are needed.

9.11 We are content with the CMA's decision to disallow the outperformance incentive associated with Yorkshire Water's Low Pressure PC. In the company's 'Valuing Water' research, water pressure was low on customers' hierarchy of priorities. The CMA's comments about its doubts regarding the high 'Willingness to Pay' value derived through the triangulation of Yorkshire Water's revealed and stated preference research are noted. CCW will be reviewing the use of triangulation at PR19 with a view to improving its application at PR24 and beyond.

9.12 CCW supports the CMA's decision to increase Yorkshire Water's exposure to penalties by adjusting the penalty collar for Internal Sewer Flooding performance. This intervention follows the principle CCW asked for in its initial submission to the CMA, that any further changes to the collar mechanism should benefit customers, not the company. Improving on sewer flooding alleviation is a high priority for customers. CCW's 2018/19 Water Mark ranks Yorkshire Water as 'Poor' for both internal and external sewer flooding, while Ofwat's latest service and delivery report placed Yorkshire Water in the lowest quartile for its sewer flooding performance.

Enquiries

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