

BRISTOL WATER PRICE DETERMINATION

Summary of hearing with the Consumer Council for Water on 17 April 2015¹

Background

1. The Consumer Council for Water (CCWater) said that it was an independent consumer watchdog in the water industry and that it looked after both business and domestic customers in England and Wales. It was set up in 2005 and paid for by water customers. It costs 21 pence per household per annum and the fee is levied on water companies in the same way that the Water Services Regulation Authority's (Ofwat) licence fee is levied. As such, water companies are required to pay this fee.
2. CCWater said its remit was to provide a national and local perspective on issues for water customers and to ensure that customers' voices were heard by companies, regulators and the government. In order to do this, CCWater undertook customer research annually. It said that as well as tracking customers' views, it also analysed companies' policies and practices and did a lot of comparative performance analysis. In addition, it also handled second level customer complaints if a customer's own company had not resolved the issue to the customer's satisfaction.
3. CCWater said it had been trying to get customers to have more influence in price setting since 2005 and it had encouraged Ofwat to introduce the customer challenge group process. The result of this being achieved was that the PR14 determination had provided a very customer-focused package, as well as also being good in terms of price.
4. CCWater said that all of its research was outsourced to specialist market research agencies and its strength was having comparative data, so unlike customer challenge groups that only dealt with one company, CCWater was less likely to be convinced by a company's claims about its performance, unless the data supported it.

¹ Two of the attendees representing the Consumer Council for Water were customers of Bristol Water.

Financeability and cost of capital

5. CCWater said it had taken a slightly different view from the local customer challenge group (the Bristol Water Local Engagement Forum) on the issue of costs. It said that customers wanted to see value for money in the packages they were receiving and that there was a concern that, according to Ofwat's modelling, Bristol Water looked to be relatively inefficient. Although it welcomed the cost challenge made by Ofwat, it had called upon Ofwat to assure itself that its cost models were fit for purpose.
6. CCWater said the PR14 price review had been the most customer focused by far when compared to other price reviews and it was confident that it reflected customers' priorities. It thought that Bristol Water had translated customers' priorities into the outcomes in its business plan. However, while CCWater thought it was very positive that Ofwat had pushed the responsibility of developing the plans to the companies, it meant that the result was lots of performance measures across the industry that were not necessarily comparable.
7. CCWater said it considered that historically, Ofwat had been overly generous on the cost of capital, in terms of the returns to the industry since privatisation. It also thought that Bristol Water, along with many other companies during PR14, was seeking a cost of capital that was too high for a monopoly industry. CCWater considered Ofwat's determination to therefore be more reasonable, although it was still at the high end of the range that CCWater's consultants had suggested.
8. CCWater said Ofwat had placed a lot of emphasis on its econometric model and then asked companies to say why the model's results needed to be adjusted. Ofwat had therefore set a baseline of what an efficient company's costs should be and companies had had to put in a case as to why they should have costs above that baseline. On this particular issue, Ofwat and Bristol Water seemed to disagree over the validity of the evidence supplied.
9. CCWater said that 17 out of those 18 companies had accepted the cost of capital as part of the package, and that it was only Bristol Water that was suggesting it needed more.
10. CCWater did not think Bristol Water's claims for increased cost of financing should have an impact on the rates set for the determination. It questioned why companies that had taken advantage of the low cost of debt over the last few years and geared up should expect customers to bail them out in the future. CCWater said it was concerned about whether the differential between the cost of equity and the cost of debt over the last few years had prompted

some companies to gear up, potentially unsustainably. It thought that this was one of the potential negative consequences of the methodology.

11. CCWater said that one of Ofwat's primary duties was to ensure that companies could deliver on their investment programme, and it was concerned that some companies may be encouraged to adjust their pay-as-you-go ratio to overcome short term blips in financeability. CCWater did not want companies to make adjustments at the expense of customers. CCWater said that Bristol Water had not spoken to customers about the effect on current and future average bills.
12. CCWater said there was no specific correlation between smaller companies and better customer service, and it did not think that customers should pay a premium for being served by a small company. Hence, it supported Ofwat's challenge to small companies to explain why it was in the customer's interests for the company to be given small company premium. CCWater did not think that Bristol Water was giving customers anything beneficial as a result of being small. In comparison, Sembcorp Bournemouth Water and Portsmouth Water had provided evidence that the value of benefits to customers was at least equal to the extra cost of financing.
13. CCWater said that it had seen no evidence that larger companies could deliver services more cheaply or efficiently. While there may be scale advantages in the retail end of the business around billing systems, they were a relatively small part of the value chain. Factors such as the geographical area covered, miles between properties and whether or not it was a rural area were the factors affecting all water companies.

Customer acceptability

14. CCWater said that Bristol Water's plan and Ofwat's draft determination both received high levels of acceptability, but it was not possible to compare the two because of the different methodologies used. CCWater said that customers were extremely supportive of both scenarios and this was due to customers' priorities being embedded into both. CCWater said that the outcomes needed to remain the same in the CMA's re-determination, but the costs needed to be challenged.

Performance commitments

15. CCWater said that customers wanted a safe, reliable supply of water, both now and in the future, with few interruptions or leaks. Customers expected these outcomes to be delivered efficiently, with their company performing well in comparison with others. On the whole customers were highly satisfied with

the service provided by most water companies. However, satisfaction with value for money was much lower across the industry, and CCWater said this was due to 50% real term price rises over the years since privatisation.

16. CCWater said that the research done across the industry showed broadly similar priorities, although there were slight regional variations. It said that value for money was an issue across the whole industry, and while it understood the regulatory logic behind incentivising companies, the general view of customers was that they did not see why they should pay their water company more to do what they should be doing in the first place.
17. CCWater said Bristol Water had conducted some research in 2013 into what customers thought about companies being rewarded for outperforming and customers had reacted strongly against such a proposal. As such, Bristol Water did not include financial rewards in its December 2013 business plan. However, it had been instructed to include them by Ofwat. CCWater said Ofwat had done this to encourage companies to manage their businesses better and deliver results for customers. But customers did not support this and CCWater said it was possible that companies could deprioritise aspects with no reward or penalty attached and then the service could get worse.
18. CCWater said that its research showed that just over half of customers thought their bills were fair, and a lot of companies had used this particular price period to reflect on this view. It said that if Ofwat's cost model was correct, then Bristol Water should be able to deliver the desired service at the correct price and that customers would not expect to be paying over the odds because of financing decisions that the company had made in the past. It said customers expected value for money and an efficient company, and that Bristol Water should be trying to reach a level of performance comparable to the top end of the industry.
19. CCWater said that it could not say if Bristol Water was inefficient, but Ofwat's analysis suggested that it was. CCWater said that Bristol Water's performance on some key measures, notably interruptions to supply, seemed to be poor when compared to the industry. In 2010/11 Bristol Water's performance had been 30% better than the industry; now it was 60% worse than the industry. This was a significant shift in a very short period.
20. CCWater said that it thought that Bristol Water's performance around supply interruptions had deteriorated over the last four years, both on an absolute and on a relative basis. It also thought that the performance commitments were possible to achieve with the expenditure reduction proposed by Ofwat, presuming the model was correct.

21. CCWater was now less supportive of Cheddar Two Reservoir and Bristol Water's investment analysis, mainly due to the fact that CCWater had received updated information about the water needs of the Seabank power station. CCWater thought that demand across Bristol Water's area of supply would be less than anticipated and therefore Cheddar Two would not be needed before 2030. It also said that Bristol Water was pessimistic around household demand in comparison with other companies and it thought Bristol Water's headroom analysis was out of kilter with the rest of the industry and did not meet the Environment Agency's guidelines.