



**The Consumer Council for Water's
submission to the
Competition and Markets Authority
about its provisional findings in the case of
Bristol Water's appeal of price limits 2015-20**

July 2015

1. Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory independent consumer organisation representing household and non-household water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales.
- 1.2 CCWater's role involves providing a strong national and regional voice for consumers through advocating consumers' views to the water industry, regulators and governments, and taking up consumers' complaints if they have tried and failed to resolve issues with water companies.
- 1.3 CCWater played an important part in the 2014 price review process. We were members of all 18 Customer Challenge Groups (CCGs) across the industry¹, including Bristol Water's Local Engagement Forum (LEF). We also chaired the LEF's sub-groups that focused on Bristol Water's customer research through the price review, and investment decisions.
- 1.4 We also commented separately to Ofwat about company business plans, the weighted average cost of capital, and other important aspects of the price review.
- 1.5 We submitted written views to the Competition and Markets Authority (CMA), and were grateful for the opportunity to give evidence in person on 17 April 2015.
- 1.6 Following the CMA's provisional findings on Bristol Water's appeal, we welcome the chance to submit our further views. This submission is independent to the LEF submission.

2. Executive Summary

- 2.1 CCWater broadly supports the CMA's overall package. In particular, we support:
 - the CMA's challenge to Bristol Water to maintain its network in a cost-effective, efficient way, without reducing service to its customers.
 - the CMA's provisional findings in relation to the performance commitments on interruptions to supply, mean zonal compliance and discoloured water contacts.
- 2.2 We would, however, like the CMA to give further consideration to:

¹ CCG's are independent groups of regulators and customer representatives established at the 2014 price review to scrutinise and challenge (where necessary) water company's 2015-20 business plan proposals.

- Its proposal on the cost of capital, which is above what our consultants advised, and Ofwat concluded, was sufficient to finance water companies given the low risk industry they operate in.
- Whether the operation of the Southern Resilience Scheme would be compromised without Rowberrow service reservoir.

3. CCWater’s response to the CMA’s provisional findings

3.1 Wholesale Totex

A key part of Bristol Water’s appeal is the significant difference of opinion with Ofwat on required wholesale totex necessary to deliver outcomes for customers and the wider environment. Therefore we welcome the CMA’s assessment of both the proposed costs from Bristol Water and the modelling used by the company and Ofwat to set efficient wholesale costs.

We note the factors the CMA found in:

- Ofwat’s modelling approach when applied to Bristol Water;
- the over-estimation of costs in Bristol Water’s Statement of Case and the modelling used to support it; and
- third party evidence that Bristol Water had been relatively inefficient in the past.

We note that the CMA does not include funding to rebuild Cheddar Water Treatment Works, which could add up to c£20million when an option to address the algae problem has been agreed.

In our earlier submission, we highlighted how customers’ would expect the outcomes they receive to be delivered at an efficient cost. We welcome the CMA’s work in assessing wholesale costs on this basis. We note that the overall effect on the average customer bill from the CMA’s decision to give an additional £20million² allowance (and the small uplift in the cost of capital, commented on below) adds £4 over five years to the bill impacts implied in Ofwat’s Final Determination. Overall, this still represents a real term price decrease for customers from their 2014-15 bill.

3.2 Cost of Capital

We agree that the Weighted Average Cost of Capital (WACC) should be sufficient to allow Bristol Water to raise finance in order to deliver required outcomes for customers efficiently.

² This is separate to the Cheddar WTW £20m.

We welcome the CMA's challenge to Bristol Water's proposed WACC of 4.37%, but have some concern about the CMA's proposal.

We note that the CMA used the same assumption of notional gearing (62.5%) as Ofwat. Also within the overall WACC calculation, the CMA has recommended a cost of debt (2.59%) consistent with Ofwat's Final Determination and the recommendations to CCWater provided by Economic Consulting Associates (ECA) in their 2014 report for CCWater³.

The CMA's uplift in the WACC to 3.65% for Bristol Water, compared to the Ofwat Final Determination of 3.6%, is due to a revision in the assessment of risk in the cost of equity. This is reflected in its calculation of the equity beta at 0.85, compared to Ofwat's 0.8 and Bristol Water's 0.98.

We would like the CMA to re-consider its assessment of risk as represented by the equity beta within the context of the analysis ECA has undertaken for CCWater. ECA used evidence from the markets and regulatory precedents, comparing this evidence to its relevance in the (largely monopolistic) water sector⁴. Reflecting on ECA's evidence and recommended equity beta of 0.5 to 0.6, we question whether the equity beta proposed by the CMA is too high.

3.3 Maintenance

We welcome the CMA's challenge to Bristol Water to maintain its network in a cost-effective, efficient way, without reducing service to its customers. This addresses customers' fears⁵ that if maintenance levels fell there would be future problems and service failures. The CMA is being clear that service to customers should not reduce.

3.4 Southern Resilience Scheme

In research undertaken by CCWater and by water companies over many years, customers have repeatedly stated that their top priority is a safe and reliable supply of water. It was on that basis, together with clear evidence from the company about its customers' views, that we supported the inclusion of the Southern Resilience Scheme within Bristol Water's Business Plan.

We are, therefore, concerned about the effect that removal of Rowberrow service reservoir could have on the integrity of the scheme, and on growth provision for Weston Super Mare.

³ <http://www.cwater.org.uk/wp-content/uploads/2014/07/ECA-CCWater-Cost-of-Capital-summary-report.pdf>

⁴ <http://www.cwater.org.uk/wp-content/uploads/2014/07/ECA-CCWater-Cost-of-Capital-Setting-the-Scene.pdf>

⁵ Bristol Water qualitative research – June 2013 which compared four different bill and service scenarios.

We understand from Bristol Water that without Rowberrow service reservoir (or an appropriate alternative) there may not be sufficient water available to operate the scheme as fully intended.

We consider that funding should be included for Rowberrow (or an identified alternative) in the CMA's final re-determination. If it is not, then we ask the CMA to provide assurance that its removal would not compromise the provision of a reliable supply to customers.

3.5 Performance Commitments

Mean Zonal Compliance and Discoloured Water contacts

We welcome the CMA's provisional findings in relation to Bristol Water's performance commitments on mean zonal compliance and discoloured water contacts.

Unplanned supply interruptions (customer minutes lost):

We support the CMA's approach of reducing Bristol Water's target to 6.15 minutes, based on analysis which uses three year data rather than the one year data used in Ofwat's Final Determination.

We think the ability of water companies to record all their interruptions regardless of length is important in assessing service levels to customers. We would encourage other water companies to consider reporting against this measure during AMP6 even though it is not a formal performance commitment, and for Ofwat to make this a comparative measure at the 2019 price review.

In the meantime, we will monitor Bristol Water's performance against this revised measure, and review what scope exists to compare the company's performance against the wider industry.

3.6 Cheddar 2 Reservoir

We support the CMA's decision to not include funding for the Cheddar 2 Reservoir for AMP6. We would expect Bristol Water to now work with the Environment Agency, Ofwat and CCWater to assess future demand and identify how this could be met through various options for supply demand measures.

3.7 Cheddar Water Treatment Works (WTW)

We support the CMA's proposal to include funding for further investigation into options for addressing the water quality issues at Cheddar WTW, so as to ensure customers pay for the best value solution.

This approach will allow a full exploration of options, including investigating the possibility of more innovative approaches that may have been trialled since Bristol Water considered their plans for the treatment works. If there

is a solution that is effective, but costs less than the £20.8 million current proposal by Bristol Water, we would welcome this alternative.

However, if Bristol Water can provide compelling evidence that re-building the works is in the best interests of customers, we would welcome funding for it being included in the CMA's final re-determination.

3.8 Bedminster Reservoir

We have previously given conditional support to the replacement of Bedminster Reservoir, if Bristol Water were able to provide “more robust evidence that this scheme is needed to address risks to the supply/demand balance and the resilience of the service to customers.”⁶

The CMA's provisional conclusion appears to suggest the necessary evidence is lacking. It is now up to Bristol Water to provide the relevant evidence to explain why replacing Bedminster Reservoir is the best option for customers.

4. Conclusion

Overall we support the CMA's provision findings in the case of Bristol Water, but ask that the CMA gives further consideration to its decision on the issues of:

- Cost of capital;
- Funding for the Rowberrow service reservoir within the Southern Resilience Scheme.

⁶ CCWater's response to Ofwat on their draft determination of Bristol Water - October 2014- link [here](#)