

PENNON GROUP/BOURNEMOUTH WATER MERGER INQUIRY

Summary of hearing with Charles Howeson on 22 July 2015

Background

1. Charles Howeson (CH) said that his written submission to the CMA represented views from both the Bournemouth Water (BW) and South West Water (SWW) customer challenge groups (CCGs) that had now been disbanded. He emphasised that both groups had signed off on the submission as fully representative of their views and stated that he had been the independent Chair of both CCGs.
2. CH said that both water companies had formed a CCG three years ago, before the latest determination, in order to scrutinise and challenge the companies' emerging draft business plans. The CCGs were made up of other regulators and people representing bodies that spoke for customers. The purpose of the CCGs was also to consult with the customer base when needed.
3. The CCGs had been able to ask the companies to commission research on their behalf in order to get customers' opinions on a whole range of questions, for example their tolerance for paying to safeguard supply or quality, or to make environmental improvements.
4. CH said the CCGs had had a role in price setting for the 2014 price review (PR14) and no price review had ever had so much customer engagement before. The CCGs had challenged the business plans, provided guidance regarding what customers were happy to have, and were prepared to support regarding the investment priorities, and these responses had had an effect on the companies' bottom lines.
5. The CCG for BW had looked at the commercial sensitivity of the lack of commercial customers to determine if it should recommend to Ofwat that BW should have a small company premium. Ofwat had supported the CCG's recommendation based on the research that the CCG had done and CH said this showed the level of impact the CCGs had had.
6. The CCG for SWW had ended with the final determination, but SWW was now in the process of forming 'WaterShare', a comparable customer view group that was one of the recommendations that the CCG had made for the

next price control. CH said that WaterShare had been developed by SWW, but that it had come out of the work done by the CCG. CH said that WaterShare's purpose was to hold SWW to account for the output commitments for the final determination and that he had been elected as the Chair. The rest of the WaterShare panel would be formed within the month and it would be operational by 1 September 2015.

Benchmarking

7. CH did not think that Ofwat's model was as relevant as it had been for PR09. He stated that there was a built-in dynamic by Ofwat to keep the maximum number of comparators available to support an existing model, but that the industry had moved on since the assumptions were spoken of before. Therefore, he thought that today Ofwat could make better comparators through allowing the water map of the UK to be rationalised, principally in the interest of the industry's customers. CH did not think Ofwat had sufficiently weighted the interests of the customers, but rather that it just wanted to preserve its model.
8. CH was comfortable with much of Ofwat's modelling, but he felt that Ofwat's objection to the loss of a comparator was overstated and that the decrease from 18 companies to 17 would not actually disadvantage Ofwat. However, CH did feel that it would benefit customers. He suggested that WaterShare's own estimate was that from 2020 onwards the bills for the customers of SWW and BW would actually fall by around £6 as a result of the merger (gained from rationalisation efficiencies). He stated that there should be savings due to the fact that the acquiring company was five times the size of the company being bought.
9. CH said that for the next price review all reporting for BW and SWW would be independent.

Outcome delivery incentives

10. CH said that outcome delivery incentives (ODIs) were an important part of companies' business plans, and that the CCGs had been involved in setting the ODI targets for the two companies. Ofwat had used some benchmarking with a limited number of ODIs, and CH thought it had been beneficial. However, he did not believe that Ofwat insisting on a reward formula had been a good idea, although he was not against penalties being introduced.
11. CH said that neither board had liked the suggestion of rewards, and all water companies had been concerned about their reputations as they had not wanted themselves to be damaged in their customers' eyes by rewarding

themselves for doing what they should be doing as a matter of course. SWW and BW had only created a formula for the reward mechanism after Ofwat had insisted upon it.

12. CH said research had been undertaken for both household and business customers, so everyone had been fully surveyed, and he described WaterShare as a measure of success.

Innovation and best practice

13. CH thought SWW was, and remained, innovative, and was at the top of the tables technically.
14. CH thought that WaterShare was particularly innovative as it was the only one in the country, and he felt that Ofwat saw it as an exemplar and would have liked other companies to do it.
15. CH said that Ofwat was keen for everyone to do best practice, but it was bad at advocating it. CH did not think Ofwat prescribed anything until it was forced to do so, and therefore to get a steer, companies had to have informal meetings. CH said that Ofwat had been very supportive of WaterShare, so it could have told other companies that it was keen to see a similar mechanism being adopted, but to date Ofwat had not set a visible lead in this direction.

The merger

16. CH said that the CCGs had not been consulted on the merger. However, he did not see any downside to the merger. He thought that Ofwat would not be happy that it would have one fewer company to use for benchmarking, but both companies would report separately until 2020, so he did not see it as problematic.
17. CH thought, in general, mergers and acquisitions in the water industry would lead to clear efficiencies, but that Ofwat was not willing to have a dialogue around this. He thought the industry was moving away from comparative benchmarking to customer frameworks, therefore ODIs and outcomes. He did not think service levels would decrease, but efficiencies would be obvious.
18. CH said that if the positives from both companies were brought to the merged entity, improvements would be made. For example, SWW's WaterShare could be expanded to BW customers and SWW could improve its customer handling as a result of learning from BW, as its customer acceptance was high for BW, especially with regard to complaint handling. In addition, as mentioned previously, the rationalisation of the back office could mean cheaper bills for customers.

19. SWW had been the smallest water and sewerage company, and after the merger it would still be the second smallest, so CH did not think a major shift would take place, and he said there was significant customer support for the merger.