



Notes of the Customer Advisory Panel meeting 18 June 2013

Present

David Caro, Federation of Small
Businesses
Sharon Darcy, Consumer Futures
Deryck Hall, Consumer Council for
Water

Sue Pretty, Asda
Bob Spears, Utility Consumers
Consortium

Apologies

Susan Foster, Government
Procurement Service
Derek Holliday, Country Land and
Business Association

Patrick Law, Barratt Developments Plc.
Teresa Perchard, Citizens Advice

Ofwat

Keith Mason, Senior Director of
Finance and Networks
David Black, Director of Economics
Rob Powell, Delivery Director, Price
Limits

Alison Cullen, Senior Consumer Policy
Analyst (Secretariat)
Gail Harris, Stakeholder Relationships
Co-ordinator (Secretariat)

1. Introductions and Welcome

KM welcomed all present and thanked everyone for attending. He advised the panel that Andrew Bainbridge of the Major Energy Users Council had decided to leave the panel to allow more time for MEUC work.

The notes of the meeting of 2 May 2013 were agreed subject to the addition of 'and connections' to the first paragraph under the retail heading on page.

Action: Ofwat to amend notes, send to the panel and publish on the Ofwat website.

Actions arising from meeting 2 May 13

There was one action arising from the meeting, which was for Ofwat to ensure that the panel's views are highlighted when deciding the final methodology and to feed back at future meetings. KM advised the panel that Ofwat's relevant policy leads have been asked to consider the views of the panel when finalising their policy statements, and that this would be tracked. The way in which Ofwat feeds back to the panel how those views have been reflected in the final methodology was discussed later in the meeting.

2. Setting price controls –response to the business planning expectations consultation

Rob Powell of Ofwat gave a presentation to the panel on the key themes of the responses that Ofwat had received on its consultation [Setting price controls for 2015-20- business planning expectations](#). There was also a recap of the panel's comments from its discussion of the consultation at the meeting on 2 May. The panel were invited to provide further comment for Ofwat to consider as it moved towards the final methodology statement in the summer.

The following points were made in discussion:

Criteria and incentives

At the last meeting the panel said that the word 'acceptable' should be included in the definition of a high quality business plan. Ofwat explained that acceptability was a theme that cut across a number of the risk based review tests and that it might be most appropriate to take a broader view of acceptability.

At the last meeting the panel suggested that the affordability test in risk based review should be separate from the financeability test. Ofwat stressed that the two tests were always separate tests. It could make clearer that business plans would have to pass tests of both affordability and financeability. The panel accepted this and agreed that the two issues are 'two sides of the same coin'.

Panel members felt that Ofwat could reinforce the message about financeability and affordability by reminding stakeholders about its statutory duties.

Ofwat should ensure that the dis-benefits of companies not achieving a high quality business plan are made clear as well as the benefits for companies who do.

While an early decision on the business plan assessment incentivises companies to aim for an enhanced category, Ofwat should ensure it allows enough time to make robust decisions about companies whose plans may be on the border between standard and resubmission. The panel understood why Ofwat did not intend to publish detailed thresholds for the risk based review tests to avoid companies seeking to do just enough to pass rather than genuinely striving to deliver the best possible plan. However, it is important that Ofwat is transparent and has a defensible reason for allocating a plan to a particular category, especially for resubmission.

Ofwat should consider holding a dialogue with companies where elements of its plan were 'on the border' between two of the processes. But equally Ofwat must ensure that companies are incentivised to produce a clear high quality plan and it must be consistent in how it deals with companies.

In discussing consultation feedback about potentially dropping the resubmission process (either entirely or just for the retail elements of plans, reflecting their materiality), the panel supported having the three processes for the business plans and felt strongly that these should be applied to the retail element of the plan to incentivise excellence in key customer facing aspects of the business.

Panel members also agreed that there should be incentives for companies to aim for 'enhanced' business plans. The panel noted the trade-offs that need to be made in respect of the timing of decisions on the resubmission category.

CCGs

Panel members commented that it was possible that CCGs might not reach a consensus of opinion on a company's engagement or whether the business plan reflected the results of that engagement. Ofwat suggested that the CCG does not have to reach a consensus and the CCG report should clearly explain any differences of opinion where they occur. In the unlikely event of a CCG report not adequately reflecting this difference of opinion any member had the option of raising this with Ofwat.

Ofwat should explain the role of CCGs for companies in the resubmission process in the final methodology.

CCGs should have access to good information, generally provided directly to them by companies. Ofwat confirmed that it was about to provide the CCGs with targeted information relevant to the role and work of CCGs through CCG webpages. This would bring together comparative information based on companies' KPI performance in 2011-12. The KPI data would be updated in August following companies' data submissions in July. The CCGs would also have the draft baselines and draft determinations to inform further challenge of companies' plans after risk based review. Ofwat had to be fair and consistent in what information it provided, and avoid inadvertently signalling that CCGs should be challenging particular issues through any data it provided. Some Panel members advocated much more detailed information provision from Ofwat, specifically capital maintenance activity, past efficiency targets and performance and sewer flooding targets and performance. Ofwat's view was that such information should be readily available from companies and would not be helpful for all CCGs. Panel members suggested that Ofwat would provide the full picture whereas some companies might be inclined to provide a partial picture.

The panel felt Ofwat needed to emphasise the long term messaging on the CCG process. This would allow them to be more robust knowing that Ofwat supported the process over the longer term and intended to continue with it.

CCG chairs should ensure that the CCGs' views are properly represented in the CCG report.

Action: Ofwat to highlight these additional comments to the relevant policy leads in Ofwat for consideration for the final statement.

3. Setting price controls –cost of capital issues to be considered

David Black of Ofwat gave a presentation to the panel which outlined:

- why cost of capital is a key driver of regulated prices;
- how Ofwat assessed the weighted average cost of capital (WACC) for the 2009 price review;
- what Ofwat said in its [methodology consultation document](#); and
- the issues to be considered for the 2014 price review.

The following points were made in discussion.

Legitimacy and transparency were key to customers on financing issues. If companies behave in an open and transparent way customers might be more inclined to respond positively, for example, to companies' requests on demand management.

The panel supported the observations made by Ofwat's Chairman in respect of 'sharing pain and gain'.

The panel were satisfied with Ofwat's explanation of how its policies and ring fencing seeks to protect customers from shocks including those to highly geared companies. It is important that these are robust for the 2014 price review.

Even where issues such as the tax issues, which have been recently publicised, fall outside Ofwat's statutory powers, Ofwat should make every effort to clearly demonstrate to customers how it protects customers.

With the introduction of the average cost to serve mechanism, Ofwat must ensure that it sends out clear signals that incentivise relevant companies to keep their costs below average. The panel asked whether companies that had below average ACTS might be allowed a higher retail margin.

Ofwat needs to consider the role of setting cost of capital in context of risk based review, in particular, the extent to which companies that are considered to be enhanced might propose a different cost of capital.

The panel reminded Ofwat of its comment at the last meeting about making sure that the potential for late adjustments such as in the cost of capital does not dis-incentivise companies from aiming for an enhanced category.

The panel welcomed the scenario analysis that Ofwat is undertaking for the 2014 price review and assessment of the balance of risk between companies and customers.

The panel supported Ofwat's approach to PR14 is seeking to return ownership and accountability to companies and their Boards and hoped that companies were stepping up to the mark.

4. Customer Advisory Panel's work and next meeting

A slide was presented to the panel, which provided details of their seven meetings since the inaugural meeting in February 2012, and what price review issues the Panel had discussed in those meetings.

KM explained that the outputs from the last two meetings will inform the final statement, which will include business planning expectations. Ofwat will publish this in the summer. KM proposed that CAP's work was, therefore, drawing to a natural close and that one more meeting in early autumn should be held. At this meeting Ofwat could confirm its final methodology and explain how CAP's views had been reflected. CAP members could use the meeting to reflect on how effectively the panel had worked and provide Ofwat with lessons to learn for the future.

KM asked the panel for their views.

The Panel agreed that its work was drawing to a natural close and agreed to a meeting in October and the proposals made by KM.

The panel also made the following suggestions on issues to be considered at the October meeting.

- The calibration of menus and incentives (not menu choices).
- The effects of the risk based review process on the quality of business plans.
- Moving from one price review to the next.
- Evaluation of the price review, in particular the CCG process.
- How good practice can be shared in the sector.

Action: Ofwat to do a diary trawl for the date of next meeting and views on location.

Action: Ofwat to report to CAP at the October meeting how its views have been reflected in the final methodology statement.

**Ofwat
July 2013**