



Setting price limits for 2015-20 – final methodology and expectations for companies’ business plans Customer Challenge Groups and the Consumer Council for Water briefing session: questions and answers

Q1: The methodology emphasises high quality plans grounded on customer engagement. How does customer acceptability feed into the business plans and what will Ofwat’s approach be?

- The Customer Challenge Groups (CCGs) are playing an important role in shifting the emphasis away from the regulator and placing customers at the heart of company’s business plans. They have delivered benefits already and are driving positive changes in behaviour.
- The methodology statement makes it clear the CCG should focus on the quality of the company’s engagement with customers and how well this is reflected in its plan. CCGs are not a substitute for customer engagement and are not intended to represent customers’ views. A CCG report which solely comprises a glowing report of the company will not constitute a good CCG report. A good report will be one which demonstrates the CCG has effectively challenged the company on the way in which the company has engaged with its customers and how their plan reflects this engagement.
- Customer acceptability is a really important part of the risk based review test. However, customer acceptability is one of a range of tests and it will not be enough on its own. As well as the other tests such as financiability, cost efficiency and sustainability we will also take into account the level of board assurance and current performance of the companies.
- We are currently working through all of the tests that will be part of the risk based review. We are cautious of a mechanical test (that is, x% of acceptability) as we recognise that there could be circumstances where a company is able to explain to us the reasons why aspects of their business plan did not meet customer acceptability. We are also cautious of tests on acceptability that attempt to lead customers to an answer, for example, "would you like a 2%, 4% or 6% price rise?"

Q2: Can you provide any further insight in relation to the financial structure monitoring regime? Can there be different costs of capital?

- One concern that existed was that different company structures meant that they were more or less risky than others. As part of our work on the methodology, we commissioned PwC to review evidence to test this theory. We asked the question is there any differential risk? The PwC report, published alongside the methodology, concluded that there was not any differential risk and therefore supported a single cost of capital across the industry. The financial monitoring regime will however keep these important issues under review.
- If companies think different parts of the industry should have different costs of capital, then they should present compelling evidence to support this in their plans. Unless we are presented with compelling evidence we will set a single cost of capital.

Q3: What will the CCG's involvement be in the risk-based review process?

- The CCG reports will be highly valued by Ofwat. We are particularly interested in how well the company has engaged with their customers and how well this customer engagement is reflected in their plan. We expect the CCG to effectively challenge the companies, for example where they are making trade-offs.
- The future role of the CCGs in PR14 will partly depend on the company's status. For example resubmission companies will require a new statement from its CCG to accompany their resubmitted plan.
- For enhanced companies these companies could think about how to use their CCG to embed customers' interests in the development of future strategy and outperformance under PR14. However this is for the company to decide.
- We will be publishing tomorrow a plan for delivery. To create the plan we have used certain planning assumptions and may be subject to change.

Q4: We understand that companies will be invited to present their business plan to Ofwat in December. Do you see a role for CCGs in those meetings?

- We are giving all of the companies the opportunity to come in and explain their business plan to us following submission. Some companies might not feel the need to do this whereas other companies will really welcome this chance to present a holistic view of their plans.
- We will not prescribe who will attend these meetings and it is up to the companies to decide who will attend and whether they consider that there is a role for the CCG.

Q5: How can CCG's help challenge baselines / efficiency of companies?

- We have various different models to assess the totex costs associated with the Companies. We will be constructing cost corridors and establishing whether a company's costs fall within that cost corridor. If they sit outside the cost corridor, and the companies are unable to give us compelling evidence to explain why we will talk to the companies about the reasons why and provide our assessment.
- This is the area which will involve the most technical dialogue and we do not expect the CCGs to be able to undertake this. However, the result may be that outcome incentives don't match up once revised and in those circumstances we would expect companies to re-engage with the CCG.
- We will not publish our preferred totex models or the corridors before the risk-based review (RBR). We want companies to focus on developing the best possible plan for their customers rather than focussing on meeting our tests.

Q6: When the price review process is over you do not plan to mandate CCGs. What are you going to do, as a regulator for customers?

- We will take stock of how well the CCGs have worked but companies are better placed to decide how they can use their CCGs to embed customers interests after PR14.
- Going forward, we will expect to see from the companies that they have an excellent plan in place which is customer focused. The companies can

choose to continue to have CCG engagement and involvement but we are not mandating that.

- We have created a process to change the culture in the sector. Whilst the process might not necessarily be enduring, the change in culture is. The companies are innovating and doing things differently and we are not best placed to say we know the best structure for customer engagement.
- We will determine what the appropriate arrangements for customer engagement for the next price review closer to the time.

Ofwat
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