



**Setting price limits for 2015-20 – final methodology and expectations for companies’ business plans
Non-governmental organisations (NGOs) briefing session:
questions and answers**

Q1: How do we encourage companies to be more innovative in their approach where this is good for the customers/the environment? Won’t more innovative projects unsettle investors?

- The evidence does not support the proposition that more innovative approaches will unsettle investors. The PR14 methodology encourages companies to be more innovative and we have not seen a flight of capital from the sector in response to this. In fact we have seen considerable interest from investors in water and sewerage companies, as evidenced by the premiums (in the range of 30-40%) that some investors are willing to pay.
- In addition, despite encouraging more innovative approaches, analysts’ reports published recently indicate the effect of the methodology is broadly neutral.
- If a company is incredibly risk averse in its plan and does not propose innovative approaches when these would benefit customers, including the environment, then such a company is unlikely to be enhanced. Given the financial, reputational, process and procedural benefits associated with being enhanced, this should incentivise companies to be innovative, where this would benefit customers, including the environment.

Q2: Have you considered the prospect of a challenge to the Competition Commission (CC)?

- There is always a prospect of an appeal to the CC.
- The risk-based review and price setting process will be transparent and fair.

- We will not use a tick box approach to the risk-based review which means firms will not fail on a technicality. If their business plan is excellent and reflects customers' interests then it will be enhanced.
- We will also be transparent in providing feedback to companies on their performance against the risk-based review tests and providing the totex models in 2014.

Q3: To what extent will Ofwat evaluate the effectiveness and roles of the customer challenge groups (CCGs)?

- 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 post PR14.
- There is already evidence that the CCGs 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 meant 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.
- The future role of the CCGs will partly depend on the company's status. For example resubmission companies will require a new CCG report to accompany their resubmitted plan.
- For enhanced companies there will be very little left to do for PR14. These companies could think about how to use their CCG to embed customers' interests in the development of future strategy.

Q4: Can you provide further information on the reputational Abstraction Incentive Mechanism (AIM)? In particular, how you will set baselines without penalising companies that have been making improvements recently and how you will be ranking companies.

- We will need to consult companies on exactly how the reputational AIM is going to work for the forthcoming price control period. However the way in

which this reputational incentive is going to work does not need to be finalised before business plans are submitted in December.

- We are disappointed that due to a lack of data we could not make AIM a financial incentive for PR14. However a reputational incentive based on a league table approach will still provide powerful incentives. A league table will clearly identify the high performers and low performers. Stakeholders can increase the power of this incentive and help us drive changes in behaviour by shining a light on both the best and worst performers.
- The introduction of a reputational incentive should improve the quality of data so we will be in a position to introduce a financial incentive from 2020 with a wider scope than previously envisaged, so that it covers more than just the most over-abstracted sites.
- We agree that for companies who are making improvements in this area and those proposing financial outcome delivery incentives (ODIs) on abstraction, this should be reflected in their AIM ranking.

Q5: How do we encourage customers to get more involved in the environmental campaigns run by companies?

- It is really important that we celebrate success and promote examples where companies are actively engaging with their customers and running successful campaigns. This could lead to a change in behaviour as customers put pressure on their supplier to emulate the success achieved by others.

Q6: The methodology statement makes it clear that companies need to take ownership of their business plans. Will Ofwat step in if something goes wrong?

- If companies submit high quality, well-evidenced plans that clearly reflect customers' interests then we will not step in. Outcomes should be based on what customers want – the Regulator should not be driving this. Some companies are already publishing information on their proposed ODIs, including the rewards and penalties associated with these.
- Our role is to provide a safety net. So if plans are not well evidenced or do not reflect customers' interests then we will clearly need to step in order to protect customers.

Q7: How should companies balance short term and long term customer interests where current customers may be cash-constrained? And how do they communicate these trade-offs to a broad customer base?

- The PR14 methodology is designed to incentivise longer-term planning and delivery. For example, companies are able to propose outcome commitments that go beyond 2020.
- We are already seeing more innovative solutions in Water Resource Management Plans (WRMPs), such as catchment management and companies working with local communities to address flooding, which should deliver benefits for customers in the longer term.
- The customer engagement conducted by companies should address trade-offs between customers in the short and longer terms. This dialogue should be expose the issues and drive the trade-offs.

Q8: The environment is one aspect of service quality – it is not necessarily a cost driver. What will you do if companies frame their questions for customers about environmental improvements in a negative way?

- The introduction of competition into some parts of the market should provide information on what aspects of price and service quality really matter to customers. We have seen this happen already in the Scottish retail market. As more information on customer preferences becomes available this should help to change behaviour.
- If stakeholders think that certain questions are being framed in such a way as to elicit certain answers then they should inform us (before business plans are submitted).
- We also want to hear about good examples of company engagement with their customers and stakeholders.

Q9: How do encourage companies to share information on best practice, where this does not contravene competition law?

- It is not for Ofwat to advise the companies on what information they can or can't share under competition law. The OFT provides clear guidance on their

website and it is the companies' responsibility (as in every other sector in the UK) to take responsibility for complying with this.

- There is a role for stakeholders in identifying good performers and celebrating their success, which should incentivise other companies to emulate this. There is plenty of information already available in the public domain that could allow them to do this.

Ofwat
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