

Notes of the Customer Advisory Panel Meeting 22 October 2013

Present

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

Derek Holliday, Country Land and Business Association
Teresa Perchard, Citizens Advice
Sue Pretty, Asda
Bob Spears, Utility Consumers Consortium Services Ltd

Apologies

Patrick Law, Barratt Developments Plc.

Ofwat

Keith Mason, Senior Director of Finance and Networks
Rob Powell, Ofwat Delivery Director

Barbara Hughes, Ofwat Consumer Policy Director
Alison Cullen, Senior Consumer Policy Analyst (Secretariat)

1. Introductions and Welcome

Keith Mason (KM) welcomed all present and thanked everyone for attending. At the meeting on 18 June the Customer Advisory Panel ('the panel') agreed that its work was drawing to a natural close with the publication of Ofwat's final price control methodology for 2014 'Setting price controls for 2015-20 – final methodology and expectations for companies' business plans in July. KM would review the position at the end of the meeting if the panel felt it needed to reconvene.

KM introduced the agenda containing three main sessions, as described in the section headings below.

KM ran through the actions arising from the last meeting on 18 June 13:

- Ofwat had amended both the May and June meeting notes further to comments made by the panel. Final sets of both notes had been circulated to the panel and published on the Ofwat website.
- Ofwat secretariat had highlighted the panel's additional comments to the relevant policy leads in Ofwat for consideration in respect of the final methodology statement.
- Ofwat to report to the panel at the October meeting how its views have been reflected in the final methodology statement. This would be covered at this meeting.

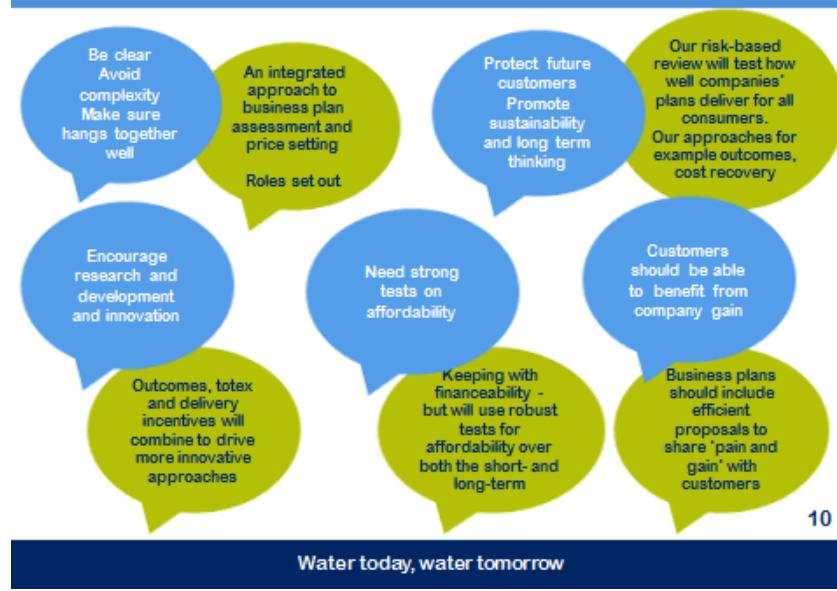
2. Setting price controls : final methodology - how Ofwat has reflected the panel's views

Rob Powell (RP) presented an overview of the final methodology statement. He explained how little the final methodology statement had changed from the consultation document, given the amount of support from respondents on the main aspects: focus on outcomes; handing back ownership to company Boards; and increasing the focus on customers. The statement highlights where we have amended our approach further to comments received.

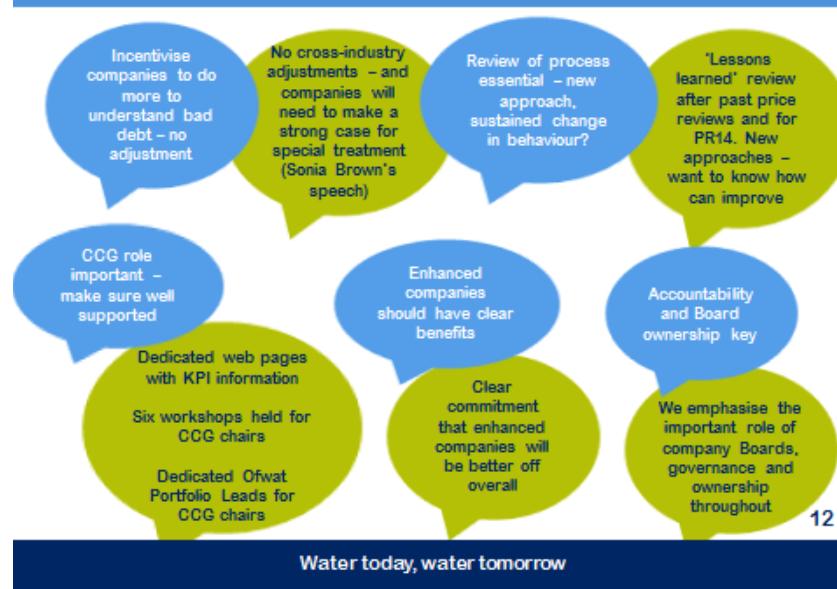
Ofwat had responded to feedback received on a range of issues such as water trading where Ofwat had simplified incentives around water to make sure that the need to increase efficient water trading is not undermined by too much complexity. In addition, the Abstraction Incentive Mechanism was to be implemented as a powerful reputational incentive until there is reliable data that Ofwat would need to set national financial incentives.

RP presented slides showing the key themes of the panel's views and how the July statement reflects these. The slides are shown on the following page.

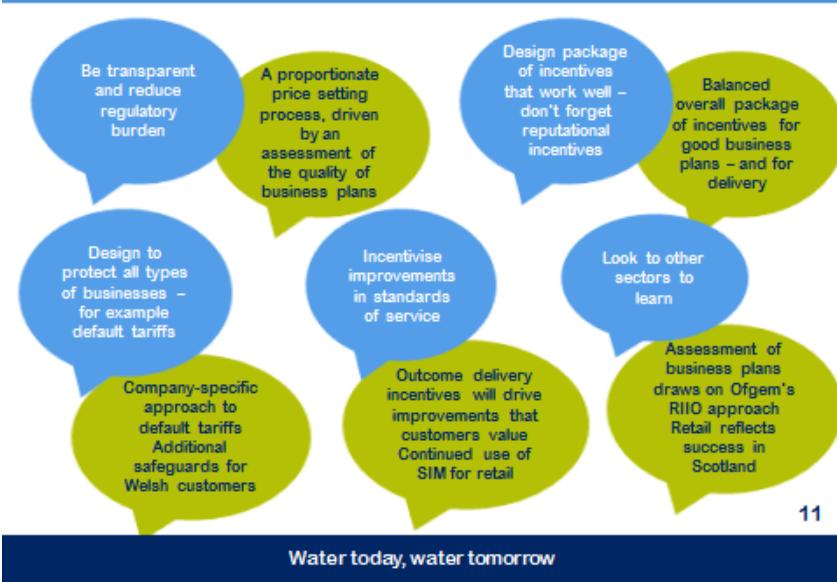
Themes of CAP's views and the methodology (1)



Themes of CAP's views and the methodology (3)



Themes of CAP's views and the methodology (2)



The following points were made in discussion:

- There is a clear need for water companies to be transparent on how they propose to share pain and gain with customers so that the CCGs can make legitimate challenges.
- Ofwat did not appear to show in its methodology how, pending competition being introduced, the default tariffs would protect business customers but be set so as not to constrain entry or choice.
- Issues relating to contracts (e.g. roll-overs, lock-ins, and simplification) still need to be explored, but these are best considered through the Open Water Programme and the High Level Group.
- It will be interesting to see how effective the CCGs have been and how useful their reports are to the risk based review.
- It is important for the Non-Executive Directors of the water company Boards to have a good understanding of the price control methodology so that they provide effective challenge to the companies' executive. KM confirmed that Ofwat had provided opportunities for the NEDs to raise any issues with Ofwat.
- There was still an opportunity for Ofwat to benefit from comparisons that can be drawn from any commonalities that emerge, for example, on outcomes and measures of success.

3. Setting price controls –final methodology updates on financial issues

KM gave a presentation to the panel which provided an update on the PR14 methodology for the following:

Financing – risk and reward and how companies can do better for their customers financially

Ofwat will require companies to propose wholesale remuneration. Companies will propose their own weighted average cost of capital (WACC) and Ofwat will compare submissions with trends in the market to determine what is reasonable.

KM provided a slide of a graph which Ofwat's Chief Regulation Officer included in her [speech to the WWT Sustainable Water event in September 13](#). This illustrated what Ofwat considered to be a huge opportunity for companies to save money and pass on the benefits to customers through the lower cost of debt.

CCWater asked for clarification on how Ofwat would handle the situation where a company proposed a cost of capital lower than that which Ofwat was minded to set. KM commented that Ofwat has said that it will set its own cost of capital for price limits. But where a company:

- had set itself appropriate efficiency targets and outcomes;
- the plan was financeable; and met all of the other risk based review tests

Ofwat would need to strongly consider the proposals. In all cases Ofwat will review the movement in the debt and equity markets since submission of the company's business plan in December 2013.

The panel thought that it is important that Ofwat communicate clearly and early on its approach to cost of capital.

PR 14 methodology for pensions costs

Ofwat had consulted on costs that may not be covered by totex but had reached no clear conclusions, given the lack of evidence, from the consultation. Having reviewed a number of options, it considered that the costs of dealing with pension deficits differ from other costs. Ofwat must have regard to its duty to finance functions and need to incentivise companies, and so has decided to treat pension deficit costs separately. An information notice would shortly be issued to explain that:

- All pension costs except for deficits contributions will be part of totex.
- Deficit costs would be dealt with on a cash basis.
- The same allowance would be given as at PR09.
- There will be an end date specified for the deficit recovery period.
- Any remaining deficit after that time is for company shareholders.

(The [Information notice](#) is now on the Ofwat website).

Some members of the panel still felt that the need for companies to manage and control accruals by, for example, closing schemes to new entrants should be highlighted. They acknowledged that Ofwat would have an end date for the recovery period. But they raised concerns about what Ofwat would do at the end of that period to comply with its duty to finance functions if companies and their shareholders had not done enough on the remaining deficit. The panel felt that Ofwat should give a strong timely message that it does not expect to see this situation at the end of the period and will not support any future request for funding. KM confirmed that this was Ofwat's intention. It was also felt that this was a good opportunity to use reputational regulation by comparing how the companies respond.

4. Looking back over the panel process – what can we learn?

KM introduced the session by reminding the panel of the context of the creation of the panel. Customer engagement was introduced by Ofwat as one of the principles of its Future Price Limits framework, and was reinforced by David Gray's review, which suggested that Ofwat should work towards reducing the dependency of the water companies on the regulator. Ofwat wanted to push the companies to listen to their customers in developing their business plans. This principle was embedded in the methodology for setting price controls for 2015-2020.

Ofwat also wanted to make sure that it listened to the customer voice when developing the policies for the price control methodology that would affect all the companies – issues that the local engagement would not capture. To do this Ofwat set up the Customer Advisory Panel.

KM explained the slides presented to the panel, which showed:

- The diagram from its 2011 customer engagement policy statement, which showed how Ofwat expected customers to be engaged in price setting in 2014.
- Some numbers including the number of meetings, topics and consultations covered by the panel
- Details of the eight panel meetings and what each meeting covered.

KM asked the Panel for their views on what they thought had worked well and what they thought could have been done differently. The panel's comments were recorded on a flipchart and are summarised as follows.

What worked well	What could have been done differently?
<p>Ofwat has been open to the panel's views and has not appeared defensive.</p> <p>The tracking and the feedback on how the panel's views were reflected in the methodology was good.</p> <p>The process was not a tick-box exercise.</p> <p>The process was enjoyable</p>	<p>The panel would have liked a more cohesive view on customer engagement – e.g. a regular agenda item so that the panel was made more aware of how the CCGs were working and how the panel could help. It would have been interesting for the panel to hear from some of the CCG chairs.</p> <p>The panel would have liked to know more about what information Ofwat was providing to the CCGs.</p> <p>Some meetings were too short with the agendas over ambitious. For some issues the panel needed more time to discuss issues and build on each other's comments.</p>

<p>and members found it interesting to hear the different views and perspective of the other members.</p>	<p>The panel would have liked to have discussed big bill drivers such as the cost of capital earlier in the process.</p> <p>The panel felt that the methodology document was too complex and that a distilled version would have been useful for some stakeholders such as the CCGs.</p>
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The panel was interested in seeing how the companies and CCGs responded to the new methodology and in seeing the results of, for example, the various outcomes packages proposed by the companies. KM suggested that the panel reconvene in April after Ofwat had announced the results of its risk based review of the companies' business plans, which would also reflect the customer engagement and the CCG process. The panel agreed that this would be sensible.

Action: Ofwat to arrange a Panel meeting for late April 2014.

The issue of how the panel members could help Ofwat to hear the customer voice going forward was discussed in the following session.

5. Looking forward – getting the customer voice into Ofwat policy

Barbara Hughes (BH) gave a presentation, which outlined Ofwat's development of a fresh set of customer policy tools. These are designed to be flexible and complementary to support its strategic objectives. The aim was for Ofwat to articulate a more powerful strategy for customers. Part of this was how to best get the customer voice into Ofwat's policies.

The presentation outlined the structures that Ofwat currently used for involving people in its work (e.g. the Panel for PR14), and those that it could use (e.g. online panels). BH asked the Panel for its views. The following points were made in discussion:

- Different policy issues would naturally lend themselves to separate panels of domestic customers or business customers. But some would benefit from various customer views and the panel had already identified the benefit of different customer groups hearing each other's perspective. The timing and emphasis of certain issues might also be different for different customer groups and one could learn lessons from the other. There was therefore merit in Ofwat having a standing panel of customers such as the CAP, which could then be drawn upon for different policy issues using a

'mix and match' approach. There could be a core standing panel with other members called upon as required.

- CCWater suggested that Ofwat should consider joint research and 'piggy back' on CCWater's tracking surveys where needed. Links in the respective websites could provide a more rounded position.
- Ofwat should utilise results of satisfaction surveys and intelligence gathering, which water companies are already doing.

As the meeting drew to a close BH thanked the panel for these initial views and suggested that she come back to them outside of the meeting for more of their thoughts.

Action: BH to contact the Panel for more of their views.

6. AOB

There was no other business. KM thanked the panel members for their commitment and input over the last 2 years and looked forward to meeting them in April 2014.

**Ofwat
November 2013**