Customer Challenge Group (CCG) Chairs meeting

Jon Ashley, Chair

Ofwat, 21 Bloomsbury Street, London
14 March 2018

Agenda

Time	Agenda item	Presenter
10.30am	Welcome and introductions	Jon Ashley
10.35	Ofwat updates • Customer engagement meetings • Stakeholder engagement (DWI, EA, NRW) • Voids and gap sites • Timetable up to September 2018	 Jon Ashley Georgina Mills Alex Whitmarsh Jon Ashley
11.20	Aide Memoire for CCGs	Jon Ashley
11.50	Break	
12.00	Preparing CCG Reports	Jon Ashley
1.00pm	Lunch	

Customer engagement meetings

Jon Ashley

Customer engagement meetings

Purpose of this session

An update on progress with the customer engagement meetings between Ofwat and the water companies.

Progress (14 March 2018)

- To date we have met with 15 out of the 17 water companies and their CCG chairs (with some rearrangements needed for the weather in early March).
- All meetings have been attended by Jon Ashley plus two out of a team of four Ofwat staff (Alison Cullen, Dan Walker-Nolan, Kay Greenbank and Justine Dade).
- The meetings have given us a good insight into what we might see in each company's PR19 business plan submissions in September 2018 and the accompanying CCG report in relation to customer engagement.
- The meetings have delivered on our objective that we have a better understanding of companies' overall approach to customer engagement and innovative approaches, which will enable us to carry out a more informed reviews of companies' business plans in September.
- We have valued the contributions of the CCG chairs at the meetings.
- We thank all of the water company teams and CCG chairs for the effort they have put into preparing for these meetings.
- The contents of the meetings are confidential, which means we cannot provide any specific details to you on what was discussed at the meetings.

Stakeholder engagement

Georgina Mills

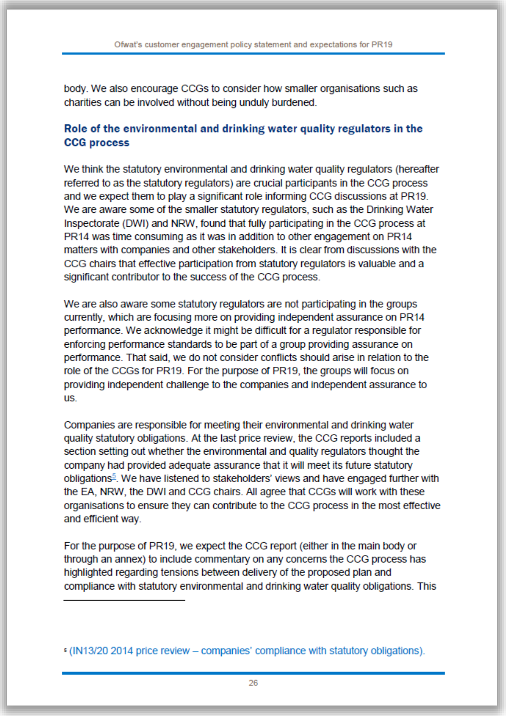
Stakeholder engagement for PR19

Purpose of this session

To explain the stakeholder engagement model for DWI, EA, NE and NRW for PR19

See pages 26/27 of our May 2016 customer engagement policy statement and expectations for PR19:

- DWI, EA, NE and NRW are crucial participants in the CCG process and should contribute in the most effective and efficient way
- "For the purpose of PR19, we expect the CCG report (either in the main body or through an annex) to include commentary on any concerns the CCG process has highlighted regarding tensions between delivery of the proposed plan and compliance with statutory environmental and drinking water quality obligations."



Ofwat's customer engagement policy statement and expectations for PR19

body. We also encourage CCGs to consider how smaller organisations such as charities can be involved without being unduly burdened.

Role of the environmental and drinking water quality regulators in the CCG process

We think the statutory environmental and drinking water quality regulators (hereafter referred to as the statutory regulators) are crucial participants in the CCG process and we expect them to play a significant role informing CCG discussions at PR19. We are aware some of the smaller statutory regulators, such as the Drinking Water Inspectorate (DWI) and NRW, found that fully participating in the CCG process at PR14 was time consuming as it was in addition to other engagement on PR14 matters with companies and other stakeholders. It is clear from discussions with the CCG chairs that effective participation from statutory regulators is valuable and a significant contributor to the success of the CCG process.

We are also aware some statutory regulators are not participating in the groups currently, which are focusing more on providing independent assurance on PR14 performance. We acknowledge it might be difficult for a regulator responsible for enforcing performance standards to be part of a group providing assurance on performance. That said, we do not consider conflicts should arise in relation to the role of the CCGs for PR19. For the purpose of PR19, the groups will focus on providing independent challenge to the companies and independent assurance to us.

Companies are responsible for meeting their environmental and drinking water quality statutory obligations. At the last price review, the CCG reports included a section setting out whether the environmental and quality regulators thought the company had provided adequate assurance that it will meet its future statutory obligations[5]. We have listened to stakeholders' views and have engaged further with the EA, NRW, the DWI and CCG chairs. All agree that CCGs will work with these organisations to ensure they can contribute to the CCG process in the most effective and efficient way.

For the purpose of PR19, we expect the CCG report (either in the main body or through an annex) to include commentary on any concerns the CCG process has highlighted regarding tensions between delivery of the proposed plan and compliance with statutory environmental and drinking water quality obligations. This

[5] (IN13/20 2014 price review – companies' compliance with statutory obligations).

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Voids and gap sites

Alex Whitmarsh

- Some customers wrongly pay too little or nothing at all. This means other customers must pay more, which is unfair.
- Current incentives on water companies are too weak to ensure they tackle this issue, so we introduced new measures in our December Methodology document.
- We only recently identified the potential significance of this issue ourselves. So we suspect customers will be unaware of it at present.

Voids are properties classed by water companies as being vacant. However, some voids are actually occupied, so they may be wrongly billed too little or nothing at all. A gap site is a property where water and/or wastewater services are being consumed, but the property is not on a water company's system and is therefore not billed.

If a water company does not bill gap sites or voids appropriately then all other customers' bills will increase, as we allow companies to recover a set amount of wholesale revenue regardless of changes in customer numbers and numbers of voids within the price control period. However, precisely because companies get a set amount of revenue, they also have limited incentives to check that all voids and gap sites are identified and managed effectively. Therefore, minimising gap sites and voids is important for affordability and fairness of charges – i.e. making sure every consumer pays and reducing charges for everyone.

In our December Methodology Statement, we introduced new measures to do with gap sites and voids. Hence, we want to bring this to your attention. The new measures:

- require water companies to come forward with bespoke performance commitments for gap sites and voids or to justify why this would not be appropriate; and
- require companies' business plans to explain how they identify and manage gap sites and voids in the residential and business retail market.

We said that, as part of this, we will expect water companies to:

- explain how they use internal and external data to inform and validate their approach; and
- consider providing a financial incentive to retailers in the business market to identify gap sites and occupied voids, if they have not already done so.

We will factor this into our initial assessment of business plans.

Why are further measures justified?

Retailers have a financial incentive to bill voids and gap sites, because otherwise they lose out on revenue allowed through our retail control. And **wholesalers** are incentivised to ensure that bills are issued for sites incorrectly classified as voids and gap sites, as a way to manage estimated leakage. There are also reputational incentives to minimise average bills.

However, there are currently also **disincentives to taking action**, because:

- it costs money to do identify voids and gap sites;
- it could harm a water company's service incentive mechanism (SIM) score, if it led to more complaints; and
- it could increase water companies' bad debt charge, if the newly identified customers are particularly likely to default.

We decided to introduce targeted incentives for voids and gap sites in our December Methodology statement, because:

- we want to ensure that water companies face the right incentives and we are worried that without further action this would not be achieved;
- recent research suggests the level of residential voids is often overstated, because of poor quality customer data and the different approaches to void management adopted by the water companies; and
- some stakeholders (two business retailers in response to our consultation and subsequently a company specialising in customer data) have said there is insufficient incentive to charge gap sites and/or voids, so they support an explicit financial incentive to encourage this.

How large and widespread is the issue?

If a notional company with wholesale charges of £350 per household customer could increase its revenue by 1% by tackling gap sites and occupied voids then this would reduce average charges for the remaining customers by around £3.50. Hence, in this scenario, the direct impact of more action on gaps and voids could have a substantial impact on bills.

However, we are unsure of the exact size of the issue. Hence, we have given companies the possibility of justifying why a bespoke performance commitment is not appropriate. We want to see more evidence and data when water companies submit their business plans.

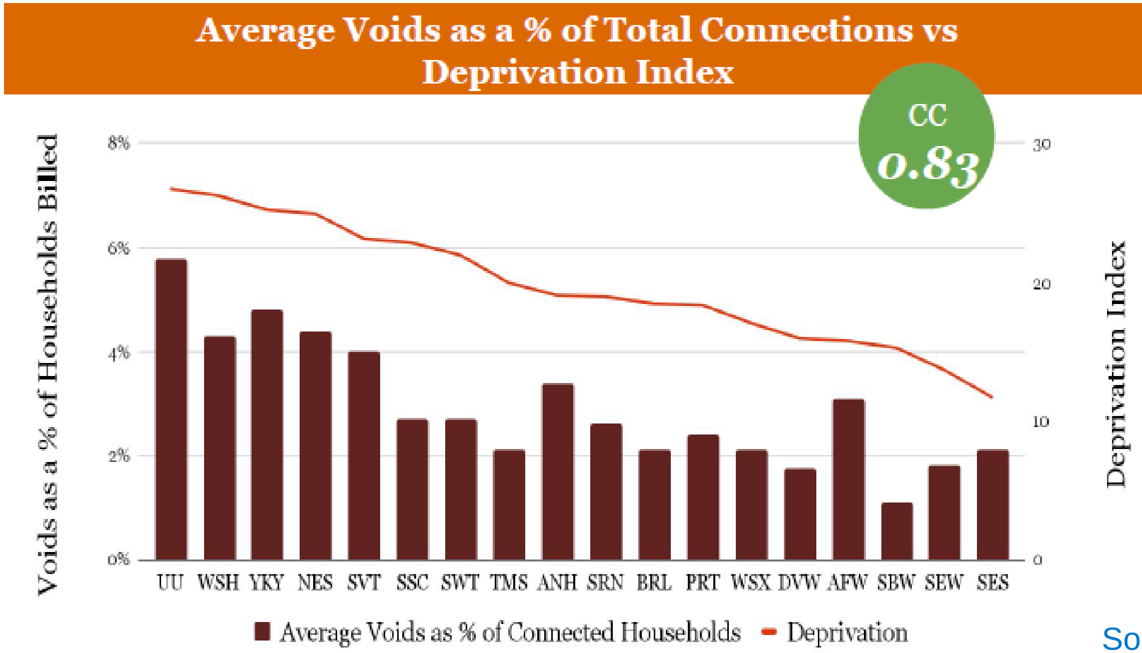
The following evidence shows the scope of the concern:

1. There is a large variation in the share of **residential voids** between companies, i.e. 1.1% to 5.8%*. Whilst recognising that data issues etc. mean some differences between datasets are inevitable, it is notable that analysis** for England based on 2015 ONS figures shows empty homes as a share of total dwellings varies from 1.7% to 3.4%. (The last slide shows more details related to this analysis.)

2. Based on conversations with third-party data providers, we understand that water companies that put less effort into managing their **residential voids** could have c. 25% to 40% of their voids being occupied. They say that this figure could be c.5% for water companies that make best use of third-party data.

3. Experience from the Scottish market after market opening there suggested that if a wholesaler provides an appropriate financial reward this can successfully incentivises retailers (and others) to identify **gap sites and voids in the business market.**

Source: *Retail Services Efficiency, PWC 2017. ** Empty Homes in England, 2016



Source: Retail Services Efficiency. Data relates to 2015

Source: Empty Homes. Data relates to 2015

Table one: number and percentage of homes empty by region

Region	Dwellings No	Dwellings empty No	Dwellings empty %
North East	1,205,096	40,784	3.38%
North West	3,214,592	105,698	3.29%
Yorkshire and Humber	2,371,671	74,841	3.16%
East Midlands	2,031,486	54,270	2.67%
West Midlands	2,431,906	63,181	2.60%
South West	2,480,287	61,711	2.49%
East of England	2,611,870	57,336	2.20%
South East	3,800,138	82,477	2.17%
London	3,504,507	59,881	1.71%
England	**23,651,553**	**600,179**	**2.54%**

Timetable up to September 2018

Jon Ashley

Timetable up to the submission of business plans

January-March	Meetings with all 17 water companies on their approaches to customer engagement.
30 March	Final date for issues and clarifications on the PR19 business plan tables and financial model.
April	Ofwat publishes feedback on company water resources RCV allocation proposals.
3 May	Companies submit: • definitions of their bespoke performance commitments; and • information on their expected cost adjustment claims. (See next page.)
May	Ofwat publishes further revised business plan tables and financial model (if required). Ofwat releases updated version of the data capture system for use with the business plan tables.
July	Ofwat provides feedback to companies on the definitions of their bespoke performance commitments.
by 15 July	Companies submit: • Annual performance reports; and • their populated PR14 reconciliation models.
3 September	Companies submit business plans to Ofwat. CCGs submit their reports to Ofwat.

Information notice on the 3 May submissions (IN 18/02 March 2018)

Our PR19 Final Methodology explained that two early submissions are due by 3 May 2018:

- Performance commitment definitions; and
- Cost adjustment claims.

Performance commitment definitions	
Common performance commitments	We are asking companies to confirm they are adopting the standard definitions and reporting guidance for the common performance commitments.
Bespoke performance commitments	We are asking companies to submit their: a) short definitions of their bespoke performance commitments; and b) their full definitions.
We will review the submissions and provide feedback to companies at the end of June or early July.	

Cost adjustment claims

- Companies are allowed to make well-evidenced claims for material costs that are unlikely to be captured by our cost baselines. Our baselines will cover base and enhancement expenditure for activities companies are required to carry out.
- Claims must be above the materiality threshold for each control. If they cover more than one control a separate claim should be made for each control.
- Likely areas for claims could include enhancement driven by unique customer priorities (rather than statutory requirements), atypically large investment schemes or unique operating circumstances.
- Companies should include projects they expect to put forward for Direct Procurement for Customers (DPC).
- On 3 May we are inviting companies to provide as much information as they can about their claims, but we recognise this information will not necessarily be in its final business plan format or fully assured.
- Early view of cost claims will help us to reach decisions on cost claims by the end of the initial assessment stage and ensure that customers are adequately protected. This is particularly important given our commitment to provide early certainty for exceptional and fast-track companies in relation to cost adjustment claims.

Aide Memoire for Customer Challenge Groups

Jon Ashley

Purpose of this session

For Ofwat to receive your comments on the Final Draft Aide Memoire for CCGs that we circulated to you on 13 February 2018.

We aim to publish the Aide Memoire following feedback from the CCG chairs meeting.

Break

Preparing CCG Reports

For discussion

Purpose of this discussion

For CCG chairs to share ideas, progress and concerns about preparation of their CCG reports for PR19.

CCGs now have:

- the Final Methodology (December 2017)
- a Final Draft Aide Memoire (February 2018) and
- the Customer Engagement Policy Statement and Expectations (May 2016).

These provide information on our expectations for companies, the purpose and role of the CCG and the information we expect the CCG to include in its report. We've also published the following response on the PR19 query log:

Question	You asked whether CCG chairs could share their plans with us in order to give us confidence that they meet our requirements.
Response	We are not formally requiring a CCG to submit anything to us other than a report on their company's business plan for PR19. We consider that the Customer Engagement Policy Statement and Expectations (May 2016) and the aide memoire should provide sufficient guidance to the CCGs on the content of their report. You do not refer to sharing draft CCG reports with us, but just to be clear we could not review draft CCG reports because that would effectively provide us evidence on companies' business plans early, ahead of the IAP starting. This would create a number of difficulties for us, including us seeing evidence on companies' business plans when they are not complete and us seeing different information from different CCGs at different times. In terms of CCG chairs sharing their plans for their work with us, we consider the best forum to do this would be the CCG chairs meetings, which are happening every two months up to August 2018. As the PR19 methodology was completed in December 2017 we will have no, or very little, new policy to present to CCG chairs in 2018 so this would enable us to spend more time at the CCG chairs meetings discussing issues such as CCG chairs' plans for their work.

Future CCG chairs meetings

Date
9 May 2018
11 July 2018
13 February 2019