

29 August, 2019

Ms Rachel Fletcher
Chief Executive, Ofwat
By email: PR19@Ofwat.gov.uk



Cc: Mr Mel Karam
Chief Executive, Bristol Water
By email: mel.karam@bristolwater.co.uk

Dear Rachel

Bristol Water Challenge Panel Response to the Draft Determination for Bristol Water

As Chair of the Bristol Water Challenge Panel (BWCP) I am pleased to report the Panel's views on Ofwat's Draft Determination (DD) on Bristol Water's Business Plan for 2020 to 2025 and on the company's response to the DD.

Introduction

The BWCP is independent from Bristol Water and Ofwat. It notes that it is not required to respond to Ofwat regarding the DD. However, the BWCP's aim is to assist Bristol Water to become best in sector through excellent customer engagement and customer focus. With that in mind, the BWCP has reviewed key aspects the DD from a customer perspective. It has also received and challenged briefings from Bristol Water on the DD and its response to it.

Context

The BWCP observes that Ofwat has modified its Price Review methodology and assumptions, especially regarding efficiency savings, financeability and requirements to meet upper quartile performance targets. These changes have implications for the company and its proposed Business Plan.

The BWCP understands that the ability for Ofwat to have a greater perspective of the business plans from across the industry means that customer preferences may need to be balanced against political, environmental, economic and technological drivers. The BWCP accepts that Bristol Water may need to make trade-offs to achieve the requirements from Ofwat.

The BWCP has challenged the company to ensure that it has conducted a thorough assessment of the impact of the DD on its business and customers and that there is customer support for the new outcomes contained within it.

The key issues considered by the BWCP have been:

- Customer bills and billing profiles. This has included the quality of customer research carried out by the company prior to and since Ofwat's Initial Assessment of the Plan (IAP) and the DD, the interpretation of the research findings and the use of the results to support components of the company's revised action plans in its response to the DD.
- The need for companies to continue to invest in assets in order to provide a reliable, safe, high quality service to customers.
- The incentives associated with Bristol Water being encouraged to meet the targets set by Ofwat.
- How investment is balanced against the incentives for customer-facing priorities.

Bristol Water has provided the BWCP with evidence to support the aspects of the DD it is accepting and those it is rejecting. This recognises that the regulator has a job to do which differs from the role that the company carries out.

BWCP's challenges

Performance Commitments (PCs) and Outcome Delivery Incentives (ODIs)

The BWCP notes that the DD contains 30 PCs and associated ODIs. This compares to 28 proposed by Bristol Water in its original Business Plan submission.

The BWCP commends Bristol Water for targeting beyond upper quartile performance commitments in water quality compliance and supply interruptions.

The BWCP notes that Ofwat is content with BW's original Business Plan proposals for:

- Value for money
- % age of satisfied vulnerable customers
- Raw water quality at source
- Biodiversity index
- Local community satisfaction
- Total customer complaints
- C-Mex
- D-Mex

The BWCP is pleased that Ofwat has accepted the company's IAP changes to the following PCs:

- Water quality compliance
- Unplanned outage
- Waste disposal compliance
- Priority services to customers in vulnerable circumstances
- AIM

- WINEP delivery and compliance (new PC added at IAP)
- Population at risk from asset failure (PC removed at DD)
- Glastonbury Street Network Resilience (PC added at DD)

However, the BWCP notes that Ofwat has rejected or revised a number of the company's proposed ODIs for:

- Customer facing PCs :
 - Supply interruptions
 - Mains repairs
 - Customer contacts about water quality appearance
 - Properties at risk of receiving low pressure
 - % age of customers in water poverty (PC replaced in DD with Helping customers who are struggling to pay)
 - Void properties
 - Leakage
 - Per capita consumption
 - Meter penetration
 - Risk of severe restrictions in a drought
- Asset management PCs:
 - Turbidity performance at treatment works
 - Unplanned maintenance – non-infrastructure

The BWCP has reviewed and challenged the thoroughness of Bristol Water's ODI analysis and has scrutinised the incentives requiring the most revision and which potentially have the most significant impact on customer bills and customer service. The BWCP considers the company's decisions regarding the trade-offs between customer bills and customer service required to achieve the DD requirements have been reasoned soundly. The BWCP has noted the following points:

- Supply interruptions – The company is currently the worst performer in industry and that a 75% improvement in performance is required to reach industry upper quartile.
- Mains repairs – An increase in underperformance penalty is required to encourage the company to carry out its repair programme.
- Leakage – A 15% reduction in leakage by 2025 will lead to better than upper quartile performance.
- Void properties – Revisions have been made in the DD to incentive caps, collars and the ODI rate.
- Per capita consumption – a reduction by 6.3% is upper quartile. The BWCP notes that company has accepted this level knowing that Ofwat is consulting the industry on a possible 10% reduction target.

Bristol Water's PR19 customer research showed that customers prefer a slower path towards asset improvements than the company originally set in its Business Plan while also keeping bills low.

Ofwat is likely to be concerned about Bristol Water's ability to deliver against its transformational plans. This is shown by increases to penalties where Ofwat observes the company has weak performance including:

- Per capita consumption
- Mains repairs
- Meter penetration

As described below, the latest customer engagement on ODIs indicates that customers want a better balance of incentives than in the DD otherwise the company may focus on service areas with big penalties and ignore other areas which are of more concern to customers. The BWCP also has concerns that excessive penalties will force the company to divert resources away from areas of service that customers value the most.

The BWCP has reviewed the changes in the level of the incentives proposed by Ofwat and the potential impact on TOTEX compared with IAP submission (which included £65m efficiency savings) and the DD proposal (which includes £134m efficiency savings).

The BWCP has received assurance from Bristol Water that the £80m efficiency savings set out in its response to the DD are achievable and do not place the customer at greater risk of higher bills or make the company less capable of being a going concern.

Customer engagement on the DD

Bristol Water has conducted two pieces of research since receiving the DD by using a quantitative online surveys, face to face interviews and through holding a meeting of its Customer Forum. The research covered Ofwat's ODI interventions contained in the DD and their impact on bills. The online research also included the company's proposed Social Tariff cross-subsidy (this was a challenge posed by Ofwat in the IAP).

The BWCP has reviewed and challenged Bristol Water's latest research on the impact of the revised ODIs on annual bills. The BWCP commented on the online research questionnaires in advance of their use and the company made some changes to the questionnaire as a result. The BWCP also attended the Customer Forum session. The views of the BWCP have been shared with the company.

The BWCP noted that the ODI research covered the revised range of incentives contained in the DD and the potential impact on asset failure, leakage and supply interruptions and the proposed increased penalties in areas where BW performance is currently weak (for example in mains repairs).

From its attendance at the Customer Forum the BWCP noted that some of the technical material presented to participants proved challenging even to those that already had some experience of the company's customer engagement surveys. However the engagement from participants was high. The overall sentiment expressed was supportive of company's original ODIs and service priorities and that some of the incentives in the DD appear to be at odds with customers' preferences, particularly those relating to asset health.

The BWCP sought and received assurance from Bristol Water of its interpretation of the research data and how it triangulated these findings with its previous research. It was particularly interested in reviewing the company's assessment of the alignment of customer priorities with the DD and where such alignment was not evident.

The BWCP also reviewed and challenged the company's latest online research into its proposed Social Tariff. The Panel reviewed the questionnaire used in the research and made several significant comments and recommendations which the company took on board before using it. The BWCP found the survey sample size and demographic spread to be reasonable. The research showed that 69% of participants consider the company's proposed £2 Social Tariff subsidy to be acceptable.

As a result of its review the BWCP considers that the post-DD research on ODIs and the Social Tariff commissioned and carried out by Bristol Water represents best practice customer engagement.

Company Assurance

As Chair of the BWCP, I was invited to attend the Bristol Water Board meeting on Wednesday 28 August where I presented our draft response to the DD and participated in its discussions on cost and efficiency, ODIs, Financial Modelling, Dividend and Executive Pay and the Resilience Action plan. The Board was very open regarding its deliberations and appeared thorough in its use of evidence and external assurance to support its own DD response. Subsequently, both the BWCP and BW Board shared their respective responses to the DD.

As a result of its challenges, the BWCP has received assurance from the company's Board and senior management that, in respect of its response to the DD, the company:

- Is capable of transforming its business practices to improve performance.
- Is committed to training and development action plans needed to implement transformation and has early warning systems in process to identify any problems
- Can finance its DD response.
- Can achieve the resulting efficiency savings through business as usual and that any risk of non-achievement will be borne by the company and not by customers through increasing water bills.

Conclusions

From its review of the DD and Bristol Water's response to it, the BWCP notes that:

- Ofwat's analysis for the DD has resulted in changes to Bristol Water's PCs and ODIs based on its wider view of the water sector and drivers such as political, economic, environmental and technological change.
- The company appears to have³ undertaken a thorough analysis of ODI changes requested by Ofwat.
- The post-DD customer engagement commissioned and carried out by Bristol Water represents best practice.
- The post-DD engagement indicates that Bristol Water's customers feel the changes to incentives in the DD are harsher than expected and, in places, at odds with local customer preferences.
- Based on penalties and rewards available to them, Bristol Water may decide which ODIs to focus on and which to accept the penalty.
- The latest engagement on the company's proposed Social Tariff shows good customer support.
- Bristol Water has assured the BWCP that the company's response to the DD is financeable and is deliverable with no additional risk to customers' bills.
- Whatever gap remains at the Final Determination, Bristol Water will need to inform customers through a range of channels of what it has to do.

I would be pleased to discuss the BWCP's views with you and to provide further information should you require it.

Yours sincerely,



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