



Ofwat: Draft 2020-25 Price Control Determination for Severn Trent Water

CCWATER RESPONSE

MAY 2019

1. Introduction

1.1. The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales. We welcome the opportunity to respond to Ofwat's 2020-2025 Draft Determination for Severn Trent.

2. Summary

2.1. *Acceptability Research:* CCWater commissioned DJS Research to carry out interviews with a representative sample of 500 customers from each water and sewerage company to test the acceptability of Ofwat's Draft Determinations.

2.2. 74% of the Severn Trent customers surveyed found the proposals acceptable (uninformed acceptability based on the bill change from 2020 - 2025). While this is a relatively high level of acceptability, it does indicate that there is a significant number of customers who do not find the proposals acceptable. Further details on our research can be found in section 3 below.

2.3. *Affordability:* We are pleased companies are making progress in supporting customers who are struggling to pay. However, we believe companies need to do more to deliver the step-change that is required. Even after the improvements companies are making, across the industry there will still be more than 1 million customers who are in need of assistance who will not be receiving it.

2.4. Our [Water Matters research](#) (2017) found that 73% of Severn Trent customers found their charges affordable. Severn Trent's own research indicates 11% of their customers struggle to pay their bills. Severn Trent's plans aim to help just under half of these customers by the end of 2025. It is important that Severn Trent continue to identify opportunities to extend support to the remainder of these financially vulnerable customers. We are disappointed that Severn Trent has not agreed to contribute directly to the funding of its social tariffs.

2.5. We recognise that in comparison to other companies, Severn Trent's bills are low, but when anticipated inflation and potential ODI outperformance payments are taken into account, bills will increase across the period. Customers who are already struggling to pay will find any bill increase difficult to cope with so, this could increase the affordability problem for some of Severn Trent's customers.

2.6. *Vulnerability*: CCWater believes that in order to judge how a company is performing in providing services for customers in vulnerable circumstances it is necessary to measure satisfaction with the service being provided and also awareness of what assistance is available. We feel that there should be more focus on identifying and delivering support to consumers in transient circumstances (i.e. consumers who find themselves in vulnerable circumstances unexpectedly and/or temporarily). Raising awareness of the support available so that customers know what help they can access - and how they can access it - is crucial.

2.7. We are pleased that Ofwat has introduced a common Performance Commitment in this area, something CCWater called for in our response to the PR19 methodology. However, we believe that there is the potential for a target which focuses solely on numbers on the register to drive the wrong behaviours, such as a focus on increasing numbers on the register without considering the quality of support provided. We will be monitoring companies' activities in this area closely to see which customers are being signed up for the Priority Service Register (PSR), for what services, and whether the help being offered is meaningful and helps customers get what they need from the company.

2.8. *Outcome Delivery Incentives (ODIs)*: We would like to see companies demonstrate a commitment to deliver exceptional performance and clear customer support for both the principle and range of ODI payments before they are included in plans or price determinations. We remain concerned about the potential for ODI outperformance payments to have a significant impact on customer bills and impact on the legitimacy of the company in some customers' eyes.

2.9. Whilst Severn Trent customers in general supported the principle of ODIs, not all customers wanted to pay more for better service and not all supported the package which was presented showing the impact. Similarly, CCWater's research to test the customer acceptability of the Draft Determination shows that acceptability reduced from 74% to 69% once customers were shown more details about the Performance Commitments and ODIs in the Draft Determinations, and the potential bill impact of these incentives. While this reflects the initial top-line research results (the full analysis will follow), it may indicate that fewer customers accept the ODI package when they see how this may affect their bills.

2.10 *Customer Experience measure (C-MeX)*: We welcome the clarity on the details of the shadow reporting of C-MeX, which will inform its final design and will monitor how this progresses. We remain concerned that there may be insufficient weighting given to a company's complaints performance so that they may be able to achieve a financial reward even where their complaints performance is poor or deteriorating.

2.11 *Cost of Capital*: We believe it may be possible for Ofwat to set an even lower Weighted Average Cost of Capital (WACC), thus delivering further bill reductions. An independent study commissioned by CCWater¹ has recommended a range for the WACC between 1.7% to 2.3%², based on an analysis of water company financing, market evidence and capital financing assumptions in other regulated sectors. This is slightly lower than the estimate that was calculated by the same consultants, ECA, back in December 2017 in its first assessment for CCWater.

2.12 ECA's range also falls below the initial view of 2.4% that Ofwat announced during the winter of 2017-18, a figure that will already ensure the average bill for 2020 to 2025 is between £15 and £25 lower than at the previous price review in 2014. However, if Ofwat were to adopt ECA's recommendations it could lead to customers being better off by between £1 to £14 more. We would like to see Ofwat reduce the WACC further as evidence shows this is feasible and will benefit customers.

¹ Update to our recommendations for the Cost of Capital 2020-25 (Economic Consulting Associates for CCWater, January 2019) – see [here](#).

² Real (RPI) WACC appointee level

2.13 Water Transfer: Customers of Severn Trent should not be expected to bear any costs associated with planning or implementing arrangements to enable the future potential transfer of water from the region to others. We expect Ofwat to ensure that Severn Trent customers do not fund such work through the price limits set for 2020-25. However, we recognise that progress needs to be made to address the future water resources needs of customers, particularly for those in the south of England.

3. Customer acceptability

- 3.1. Our DD research found that just under three-quarters of Severn Trent's customers who were surveyed think that the Draft Determination proposals are acceptable. 74% of uninformed customers said the plan was either "acceptable" or "very acceptable."
- 3.2. However, this figure dropped to 69% for informed customers. This appears to indicate that customers have some reservations about the plan when they are provided with more information about it.
- 3.3. Only half of Severn Trent's customers found the potential impact of ODIs on their bills over the period to be acceptable. In addition, more than a third of customers said that these potential changes to their bills were unacceptable, while 1 in 10 customers didn't know. This highlights the potential for there to be a significant customer backlash against the impact of ODIs on bills once this is fully realised.
- 3.4. These top-line findings give an indication of customers' feelings about the Draft Determination. The full report, which will explore in more detail the reasons behind these answers, will be published on our website:
<https://www.ccwater.org.uk/research/category/price-reviews/>

4. Bill profile and cost efficiency

- 4.1. The Draft Determination would see bills reduced by 5%, in real terms. This figure does not include inflation and the impact of ODIs, so we expect the company and Ofwat to make this clear to customers when explaining bill impacts at Final Determination and beyond.
- 4.2. We are pleased that Ofwat have now made the bill profile flat across the five-year period, as this is supported by customers. We accept that a minor change to the RCV run-off rate was needed to achieve this and to keep the plan financeable.
- 4.3. We support the proposed totex sharing mechanism and we look forward to working with the company on how they will allocate these funds, should they outperform.

4.4. CCWater is concerned that the ‘amber’ schemes in the Water Industry National Environment Programme (WINEP) for Severn Trent have not been included in this Draft Determination, which is a different approach compared with the other two ‘Fast Track’ companies. We understand that this means customers won’t pay initially for something that may not be necessary but if they all go ahead, as the Environment Agency (EA) expects, this will impact on customers’ bills in 2025-30 by over £5 a year (subject to changes in customer numbers). We continue to urge Ofwat and the EA to explore ways in which customer views can be taken into account when considering the cost effectiveness of investments to improve the environment.

5. Safe, reliable services: maintenance and long-term investment

5.1. Severn Trent’s Draft Determination appears to address their priority resilience issues. However, we cannot be sure that the company’s plan has identified and highlighted all of the risks.

5.2. Resilience can be affected by factors that may be uncertain or unforeseen now but may affect the company’s ability to deliver its services reliably and securely in the future. Therefore, we wish to see companies showing flexibility to adapt to changes to current and future risks, and demonstrating to their customers and stakeholders that they have done so.

5.3 In Ofwat’s Initial Assessment of Plans (IAP) and the Draft Determination Severn Trent were asked to provide an action plan on their systems-based approach to resilience in the round by 22nd August. Ofwat has also asked Severn Trent to *‘ensure that the company can demonstrate in the future an integrated resilience framework that underpins the company’s operations and future plans showing a line of sight between risks to resilience, planned mitigations, package of outcomes and corporate governance’*.

5.4 We look forward to seeing more detail on the company’s response to this challenge and to work with them as they develop this framework. We would also like to hear from Ofwat about the interventions it would propose to make if Severn Trent’s action plan was viewed as sub-standard.

5.5 We want to ensure there is transparency around the allocation of funding for the delivery of base and enhancement expenditure to make sure that funding is used in areas that customers regard as a priority. We want there to be a clear line of sight between customer priorities and the money being spent on resilience. CCWater wants to make sure Severn Trent is making resilience a priority and are not storing up problems in the long term.

6 Outcomes - Performance Commitments and Outcome Delivery Incentives

6.3 Severn Trent received good customer acceptance of the principle of ODIs but there were still customers who didn't like the company being rewarded for doing what they considered to be the 'day job'. Customer acceptability of the Draft Determination as shown in our research also reduced once customers were presented with more details about the 'package' of price and service changes, including information about the potential for ODIs to affect their bills in 2020-25.

6.4 We are therefore pleased there is to be an overall cap on the ODI package with a sharing mechanism if this is breached. This is especially important for Severn Trent given their current ODI performance on wastewater.

6.5 We are pleased Ofwat has looked at the balance of both water and wastewater ODIs and the balance between penalties and rewards with the overall package now significantly weighted towards penalties. However, we remain concerned that there is potential for bill levels to be significantly higher than those that will be set out in Ofwat's Final Determinations as a result of the ODI mechanism and that this will be unpopular with many customers.

6.6 In this Determination we note that Ofwat is now consistently using the common Performance Commitment (PC) description of Mains Repairs, rather than Bursts. During Business Plan preparation we accepted that the more proactive approach needed to meet the welcome target for leakage reduction would be likely to lead to the need for an increased number of repairs. However, a leakage reduction strategy should include other activities such as mains relining and replacement, as well as repairing bursts. We would like to see any initial 'spike' in the mains repairs PC target to reduce over time as the network becomes more stable and the company, in the longer term, undertakes other activities to achieve its leakage target.

6.7 The company agreed to monitor separately "proactive" and "reactive" repairs. The DD proposes that these numbers are monitored but that the PC and ODI are for the combined value. This risks undermining the efforts to continue to find leaks on mains proactively if a company is at or close to its PC target due to the number of customer-reported bursts/repairs. We do not believe that this should be allowed to act as a possible disincentive for companies to continue to fix leaks. Therefore, we believe that it would be more appropriate for the ODI to focus solely on the number of reactive customer-reported bursts/repairs. This would further incentivise companies to carry out repairs before they have a noticeable customer impact.

6.8 We are pleased that the company have stretching targets across their plan but given their current performance on leakage and supply interruptions we want to see the company increasing their performance now and not waiting until the start of the next price control period.

7 Affordability & Vulnerability

7.3 We are pleased Severn Trent have put forward an ambitious plan including comprehensive measures to help address affordability. The company is enhancing the support available through the introduction of measures such as payment breaks and payment matching. Overall it expects to give help to over 190,000 customers each year by the end of 2020-25. While we welcome the company's improvement in this area, this still leaves over 200,000 customers who struggle to pay in the Severn Trent region without any form of assistance.

7.4 We are disappointed that Severn Trent has no plans to directly contribute to fund the social tariff so that they can help even more of their customers who are struggling and will continue to press them to agree to do this. We will monitor company financial performance closely and highlight this as an option to share benefits with customers where the company outperforms its financial targets.

7.5 A target to increase numbers on priority services can drive the wrong behaviours and we want to ensure that help is meaningful for customers. We will closely monitor the types of customers (e.g. household, residents in care homes, hospices, prisons and hospitals) on the scheme and what help customers are signing up for. We will also be liaising with companies to understand which customers who would benefit from being on the Priority Services Register (PSR) may be missing out.

7.6 Ensuring companies hold accurate and relevant data is essential and is a requirement of GDPR. Customers would therefore expect that companies check the accuracy of data and that customers are receiving the support they need as a matter of course.

7.7 Part of Ofwat's vulnerability PC requires companies to contact 90% of customers on the PSR every two years. Clarity is also needed on what "contact" means. Does it involve interaction from both parties e.g. the customer and the company? If so, this is a difficult target to achieve - response to contact to check data in energy is around 50%. Will it be necessary for the checks to be done on those with enduring needs? Will companies be able to use an opt-out approach e.g. a text, e-mail or letter saying if we don't hear from you we will assume your needs remain the same?

7.8 Whilst priority service registers are effective in recording the additional support needed by customers experiencing longer term vulnerability, more needs to be done to help customers who find themselves in “transient vulnerability”. Many customers who do not consider themselves to be in vulnerable circumstances can find that this changes overnight. This was a key learning point from the recent freeze-thaw incident which saw thousands of customers who may not consider themselves vulnerable placed in circumstances where they required assistance but did not know where to go for it.

7.9 We also feel that customers receiving the support and/or their representatives are in the best position to feed back on whether the help is meaningful and there should be more focus on establishing and measuring this. To support this, a measure of customer satisfaction with services provided would be of benefit.

8 Other key company specific issues

8.1 We welcome Severn Trent’s lead in developing the new Global Innovation fund. We look forward to working with the company as they develop their thinking and research as part of this project.

8.2 We recognise that progress needs to be made to address the future water resources needs of customers, particularly for those in the south of England. However, Severn Trent customers should not be bearing any of the costs (£25m) associated with the development of plans for the transfer of water between regions, given they would be a donor region under such arrangements. In general, we have very limited details of the mechanisms by which the allowed costs in Draft Determinations, related to major schemes to enhance resilience, are to be deployed in a way which ensures that it is those customers who benefit from enhanced resilience who meet the costs of this provision. We look forward to understanding more about these proposals in discussion with Ofwat.

8.3 We support in principle the company's decision to use some of its profits to fund Community projects and we look forward to working with them on this project. We believe that this should be kept under review and revisited if, for example, the company were to deliver significantly greater outperformance than expected. It would be right that the benefits of any such outperformance were shared fairly with customers.

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