



# **Ofwat: Draft 2020-25 Price Control Determination for United Utilities**

**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 United Utilities (UU).

## 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. 86% of UU's customers surveyed found the proposals acceptable (uninformed acceptability based on bill change from 2020 - 2025), indicating a high level of acceptability from customers. Further details on our research can be found in section 3 below.

2.2. *Affordability:* While we are encouraged to see progress being made to support customers who are struggling to pay we believe companies still need to do more to deliver the step-change in this area that is required. Across the industry there will still be more than 1 million customers who are in need of assistance who will not be receiving it, even after the improvements companies are making.

2.3 Our [Water Matters research](#) (2017) found that 72% of United Utilities' customers found their charges affordable. Our DD research found that only 64% of customers thought their current charges were affordable, but this figure increased to 72% when customers were asked about UU's bill proposal for 2020 - 2025.

2.4 *Vulnerability:* CCWater believes that in order to get a good picture of how a company is performing in providing services for customers in vulnerable circumstances, they must measure awareness of the help that is available and satisfaction with the service being provided. We are pleased that Ofwat has introduced a common Performance Commitment (PC) in this area, something CCWater called for in our response to the PR19 methodology.

2.5 However, we believe that there is the potential for a target which focuses solely on numbers 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.

2.6 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). To support this, 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 *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 which could impact on the legitimacy of the company in some customers' eyes.

2.8 *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 worsening.

2.9 *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 CCWater<sup>1</sup> has recommended a range for the WACC between 1.7% to 2.3%<sup>2</sup>, 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

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

<sup>2</sup> Real (RPI) WACC appointee level

consultants, ECA, back in December 2017 in its first assessment for the CCWater. 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.

2.10 *Bill Profile:* We are concerned that the bill profile proposed in the Draft Determination would not deliver the smooth yearly bills favoured by customers. Low-income customers in particular find fluctuations in bills challenging. Ofwat should have regard to UU's customer research findings in reaching final decisions on the profile of bills.

2.11 *Water Transfer:* UU customers 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 UU 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 a high proportion of UU's customers think that the Draft Determination proposals are acceptable. 86% of uninformed customers and 83% of informed customers said the plan was either "acceptable" or "very acceptable."

3.2 Two-thirds of customers found the potential impact of ODIs on their bills over the period to be acceptable. However, nearly a quarter of customers did not believe that these potential changes to their bills were acceptable, while 1 in 10 customers didn't know. This highlights the potential for there to be a significant customer backlash against the impact of ODI outperformance payments on bills once this is fully realised.

3.3 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 11.1% in real terms over the period 2020-25, which improves on the 10.5% real terms reduction proposed by UU. 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 Whilst UU had proposed to spread the bill reduction more smoothly over the period, Ofwat's proposal is for a bigger reduction at the start of the period. Given the impact of inflation, this would produce a sharp fall in bills followed by subsequent increases.

4.3 The research conducted by UU in developing its business plan found customer support for a bill profile which ensured stability of charges over the period of the plan. We know that customers value bill stability and that low income customers, in particular, can find it difficult to manage bill fluctuations. For these reasons we believe Ofwat's Final Determination should deliver a smooth bill profile rather than the one currently proposed.

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

- 5.1 Overall we are reasonably satisfied that UU's resilience strategy appears to address the priority resilience issues for current and future customers. However, we cannot be sure that it 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 Ofwat found high-quality and convincing evidence of operational, corporate and financial resilience. We understand UU has addressed areas where Ofwat indicated some further evidence or action was required.
- 5.4 UU used risk assessment to identify and evaluate potential future risks and followed a structured approach to identifying asset and service risks associated with a range of hazards such as power failure, flooding, and cyber failure.
- 5.5 CCWater saw evidence through our involvement in the Your Voice Panel that UU was using learning points from its past mistakes in developing its future strategy on resilience. There was clear evidence of customer engagement in developing the strategy, including the use of innovative immersive workshop events.
- 5.6 Customers did not support the investment required to deliver a 15% reduction in leakage, despite recent threats of hosepipe bans in the UU region. We were pleased that UU accepted the need to deliver a step-change on leakage reduction and that customers will not fund the cost of increased activity on leakage to meet Ofwat's target above the level customers indicated was acceptable.

5.7 UU's approach led to the identification of the risks associated with the potential failure of the Haweswater Aqueduct, which supplies water to over one-third of UU's customers, and the development of plans, in consultation with customers, to address this. We note that Ofwat is continuing to assess this scheme outside of the fast-track process. We will continue to monitor progress on this issue and will challenge the company and Ofwat to ensure that the scheme is delivered in the most cost-beneficial way for customers. We would welcome more detail on how the scheme will be dealt with outside of the Fast Track DD process and what the potential impact will be on customers.

### **Water Transfer**

5.8 We consider that UU customers should be protected from bearing any costs associated with the development of plans for the transfer of water charges between regions, given they would be a donor region under such arrangements.

5.9 It is particularly important that UU customers do not bear the financial risk of associated with the exploration of options which may ultimately not lead to implementation. Under such circumstances there would not even be any longer term financial return to compensate customers for such expenditure.

## **6 Outcomes - Performance Commitments and Outcome Delivery Incentives**

6.1 Overall we consider UU's Performance Commitments and ODIs are stretching, reflect customer priorities and were developed based on extensive evidence of customers' views collected during the development of the Business Plan. However, we believe the evidence collected also confirmed that customers have concerns about the principle of companies receiving financial rewards for delivering services, and the impact this may have on bills.

6.2 CCWater welcomes the steps taken by Ofwat to moderate the potential bill impacts which might result from ODI outperformance. However, we remain concerned that there is potential for bill levels to be significantly higher what may be set out in Ofwat's Final Determination as a result of the ODI mechanism.

6.3 We welcome UU's proposals to introduce a formal voluntary benefit sharing mechanism, 'CommUnity Share', as part of its PR19 proposals. However, this will not guarantee customers protection from the impacts of ODI outperformance as it would only be utilised in the event of dividend payments or gearing being significantly higher than the assumptions made in the business plan. Furthermore, the method of sharing benefits would be determined following consultation with customers and so bill reductions would be just one potential option.

6.4 We would like to see the introduction of a scheme that puts in place protection for customers, guaranteeing that outperformance payments achieved through ODIs will be capped with any outperformance over this level; shared with customers. Without such a scheme there remains the potential for significant impacts on customers' bills which is likely to prove unpopular with some UU customers.

6.5 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.

6.6 The DD proposes that both reactive and proactive mains repairs 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.



## 7 Affordability & Vulnerability

### Affordability

- 7.1 We believe UU's plan includes comprehensive measures to help address affordability. The company is enhancing the support available through the introduction of measures such as payment breaks and a lowest bill guarantee. Overall it expects to give help to 152,000 customers each year. While we believe the industry as a whole needs to do more to help customers who are struggling to pay, we welcome the focus United Utilities has given the issue, and the financial contribution it is making to help address it.
- 7.2 We also strongly welcome the £71m funding which the company has pledged from profits to help fund customer support, an increase of 34% on its current contribution. CCWater has been calling on all companies to play their part in funding support for customers who are struggling to pay and believe this should form part of the common Performance Commitments used to assess companies.
- 7.3 Our research has found that UU's plan had the effect of increasing the number of customers who believed their charges to be affordable from 64% to 72%. There was a corresponding reduction in the number of customers who said they thought their charges were unaffordable - down to 12% from 20%.

### Vulnerability

- 7.4 We welcome UU's plans to further enhance support for vulnerable customers, extending its Priority Services Register (PSR) offering to over 105,000 customers, and improving the quality and scale of the support provided.
- 7.5 However, we would wish to continue to highlight to Ofwat our view that targets to simply increase numbers on priority services can drive the wrong behaviours. The help offered must be meaningful for customers.
- 7.6 We will be closely monitoring the types of customers (e.g. household, residents in care homes, hospices, prisons and hospitals) on company schemes 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 PSR may be missing out.

7.7 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.

7.8 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 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?

7.9 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.

7.10 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. We believe a common performance commitment should be used for this purpose.

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