

The Customer Challenge Group Response to Ofwat's Draft Determination of Dŵr Cymru's PR19 Business Plan

The Customer Challenge Group (CCG) reviewed the draft determination in its meeting on July 31st.

The CCG considered the changes in the business plan proposed by the draft determination against the findings of the customer research, which had been accepted as good quality by Ofwat with a B grading. A number of issues were discussed, and the key points are summarised below.

1) Customer acceptability of the company's business plan

The company's acceptability research found the proposed business plan to be both affordable (95%) and acceptable (92%) to informed customers, while "uninformed customers" provided an 80% acceptability score. In Ofwat's Initial Assessment of Plans (IAPs), it is noted that the levels of customer acceptability and affordability for the business plans "represent upper quartile and frontier performance respectively"

The draft determination raised a specific question on page 62 stating that "*the company's question on acceptability is leading as it contains a reference to the bill reduction being proposed by the company.*"

The CCG discussed this point and subsequently reviewed the relevant question in the survey used. This included checking the log of the challenge process in constructing the questionnaire before it was approved by the CCG for use as well as gaining confirmation from CCWater that the research (and question asked) followed the associated CCWater guidance for companies on testing customer acceptability. CCWater have confirmed that this is correct. The CCG is confident that this research was both effectively challenged and follows the CCWater guidance. The CCG does not accept Ofwat's statement in the draft determination that the question is leading and is confident in the high levels of acceptability and affordability responses in the customer research.

2) Welsh Water customer views on ODIs and Performance Commitments

The draft determination indicates that it has not necessarily been able to take full account of all late evidence, submitted after 1 April 2019 business plans and that this will be considered for the final determination. The CCG specifically highlighted the later customer research on ODIs (April 2019) commissioned following the IAP. The further research undertaken following the IAP, indicated customers did not support financial incentives for unplanned outages and per capita consumption but did indicate some support for incentives for trust, education and visitor activities. The CCG would hope that the final determination would reflect consideration of this customer evidence as part of the proposed changes to performance targets.

The tightening of targets on key performance indicators was in line with the CCG's response to the business plan. However, the company informed the CCG that in some cases they now could be at unachievable levels due additional expenditure being disallowed, with the expectation that the higher targets can be met through base costs. The CCG cannot take a view as to whether this is the case or not but the CCG would be concerned about the impact of the company accepting unachievable targets in view of its customers' the current high levels of trust in the company.

3) Customer views on bill reductions and impact on long-term aspirations outlined in Welsh Water 2050

The CCG response to Ofwat's initial assessment made it clear, that the Group is not in a position to comment on the methodology and assessment of the cost efficiency of the proposed enhancement programme. The CCG however stressed that the range of customer research consistently indicated that bill reduction was not an overriding concern for the majority of customers. The specific research undertaken by the company which asked customers to choose between two bill options ("Base" Plan and "Plus" Plan) demonstrated that a majority of customers supported the higher cost option which delivered further service improvement. There is clear evidence that customers are not willing to accept any service deterioration or reduction in critical future investment in favour of bill reductions. This has also been demonstrated in other research activity including the Welsh Water 2050 Have your Say consultation, in which Dŵr Cymru's customers opted for additional funding for social tariff and additional investment in service over bill reductions.

The CCG considered that the lower bills proposed in the draft determination were on the face of it, good news for customers but concerns were raised over potential long-term implications. The determination makes the assumption that customers would prefer the significant bill reduction rather than using the opportunity of reduced cost of capital to make greater progress to achieving the objectives of Welsh Water 2050. This is not backed up by the customer research.

CCG members are also concerned as to whether a future price review will have to increase bills significantly to fund future resilience investment, as a result of the additional bill reduction in the draft determination, when customers are clear that they do not like volatility in their bills.

Although the CCG cannot make any judgement on the financial determination, comment was made in respect to the reduction in enhancement expenditure on zonal studies where significant element was allocated to meet the legal compliance required by DWI and the long term impacts of a potential reduction in the company's credit rating that could result from the determination.

4) Implications for the funding of social tariffs

The Welsh Water business plan outlined proposals to further increase the financial support to customers who struggle to pay their bills. This was to be funded through the anticipated not for profit return on value (by not claiming its full revenue entitlement) which would be invested to support for financially vulnerable customers. The reduction in the average bill will also have a consequent reduction in the level of cross subsidy for vulnerable customers. The CCG is therefore concerned that the draft determination does not lead to unintended consequences through reducing the support available to financially vulnerable customers. The CCG raised a potential scenario where those that can afford bills have reductions of £60 per annum while financially vulnerable customers could have higher bills as the capacity of the company to invest in social tariff could be significantly reduced. This is against a context where current levels of support are not meeting the needs of all financially vulnerable customers. This is a critical short-term issue as it would impact bills of vulnerable customers from April, as well as a longer-term concern.

5) Alignment with Welsh Government strategic guidance

The CCG questioned whether the draft determination has fully taken into account different operating conditions and legislative frameworks that exist in Wales and required under the strategic guidance provided to Ofwat by Welsh Government. The CCG feels there needs to be greater clarity on this point as it would expect clearer examples of where in the determination Ofwat is recognising the different operating context, customer views and priorities of Welsh Government.

The example of the draft determination's requirement for the Merthyr super works to be undertaken through direct procurement was highlighted as being seemingly contrary to Welsh Government policy. Concerns were raised over transparency, risk and trust in this process, as it represents such a critical long-term investment.

The Welsh Government's Economic Action Plan recognises the key strategic importance of Welsh Water as an "anchor institution" that plays a critical role in local economies - *"Its investments and spending has an impact much greater than its statutory obligations"*. The company's work in Rhondda Fach, where capital investment was integrated within the long-term community regeneration of the local area wellbeing plans, was seen to be an exemplar model that would be put at risk through a direct procurement approach.

Peter Davies

Chair Customer Challenge Group

29th August 2019