

## **PENNON GROUP/BOURNEMOUTH WATER MERGER INQUIRY**

### **Summary of hearing with Consumer Council for Water on 15 July 2015**

#### **Background**

1. The Consumer Council for Water (CCWater) was set up in 2005 under the Water Act and it said it was funded by water customers via a licence fee that the water companies paid. It said it acted as the statutory consumer representative for household and non-household customers in England and Wales and spoke for customers at both a national and local level.
2. CCWater said that its Board was made up of regional committee chairs with a committee in each region in England and one committee in Wales. Meetings were held frequently with the regional water companies to review performance. Therefore, companies were dealt with locally. On an annual basis, CCWater said it published reports that made comparisons across the whole industry. As a small organisation, it focused its attention on where it believed the customer detriments or risks to be.
3. CCWater said it undertook customer research on specific issues and also tracked customers' views on a range of issues annually so that it could measure how customer views changed over time. It also monitored all the individual water companies to review their policies, practices and performance, and it handled second level complaints if a customer had tried to rectify a problem with a water company but had not felt that its complaint has been sufficiently dealt with. CCWater used the complaints it dealt with to identify systemic areas of customer detriment in the water industry.
4. CCWater was heavily involved in the regulatory price-setting process every five years, and it said it had looked at every water company's business plan in detail for the last review. It had also looked at the companies' tariff plans and had had a role in helping companies' develop social tariff plans.
5. CCWater said that it monitored all the companies' performance on a range of measures. It looked at complaint performance, customer satisfaction performance, and performance around things which affected customers such as leakage or interruptions to supply. CCWater said it received data from the companies individually and then looked for trends to see if they were improving and fulfilling their requirements. It also compared companies, and

stated that this was key because while a company may be improving, it might not be achieving as much as other companies in comparison. In addition to this, CCWater had also negotiated the Service Incentive Mechanism (SIM) with Ofwat and this incentivised companies through the use of financial rewards and penalties to improve complaint handling and customer service.

## **Relationship with Ofwat**

6. CCWater said that Ofwat had a statutory duty to involve it on issues like tariffs, social tariffs and price-setting processes. It also said that Ofwat engaged with CCWater outside of its statutory duties.
7. CCWater said that it used the data that Ofwat collected and published, and was presently working with Ofwat to decide what core data was necessary for customers and other stakeholders from 2015-16 onwards. However, Ofwat also used CCWater for intelligence gathering, as CCWater had more local contact with companies and therefore got early warnings of problems through the complaints that it saw. In addition to this, Ofwat also used CCWater's customer research.
8. CCWater said that its main area of work with Ofwat was advising it on where regulation needed to develop. For example, it had worked with Ofwat on the development of the 2014 price review methodology in terms of the role of customer engagement in price-setting. It had looked at customer detriments associated with tariffs, and was working with the industry and Ofwat on market reform in the preparations for the retail market that should deliver choice for non-household customers.
9. CCWater said that it was presently discussing the data needed to track Outcome Delivery Incentives (ODIs) that were introduced at the last price review because this data would give a picture of how well companies were performing and what level of comparability there was between companies.

## **ODIs**

10. CCWater said that ODIs were a new creation from the 2014 price review. ODIs allowed companies to identify measures to track the delivery of outcomes that customers wanted and were willing to pay for. Ofwat had been keen to turn them into incentives using reward and penalty mechanisms because it wanted the management of each company to be incentivised to improve the performance on things that mattered to customers.
11. However, research done by some companies, along with CCWater, suggested that customers did not support payment of a reward for what they

saw as a company's achievement of a level of service that customers viewed as something a water company should be providing as a matter of course. During the price review, in CCWater's view, it seemed as if some companies could be incentivised for a level of performance that another company would have as a standard pre-existing performance level, or even that it may be penalised for. CCWater had raised this with Ofwat, and this had resulted in Ofwat reviewing six different areas of performance that were common across all companies. CCWater said that there were 522 different ODIs across the industry covering a variety of different areas of service in both the retail and wholesale sides of the water companies' businesses.

12. CCWater believed that Ofwat had been right to intervene regarding ODIs, even though it was late in the price review process, due to the fact that some of the performance measures were too easy for some of the companies and therefore more rigor was necessary, especially as there were financial incentives involved. It said that ODIs were a work in progress. It added that comparative data was important because there was a reputational incentive on a company that was performing less well than other companies to catch up.
13. CCWater said that the risk around ODIs was reputational as customers perceived leakage or sewer flooding as something that should be dealt with normally, not an exceptional achievement that deserved a reward. It said that customers were not necessarily against the performance targets, and they supported penalties. What customers disliked were the financial rewards attached to the ODIs.
14. CCWater said that there needed to be greater comparability across the key range of measures. Given the number of ODIs, it may not be practical to do it for all 522, but rather the focus should be on the ODIs that were most important to customers, or which had the greatest customer impact. It also said that for PR19, there would be five years of data against all the measures that could be used to inform performance targets going forward from 2020.
15. CCWater said prices in real terms were coming down as a result of the 2014 price review, but in a few years they could go up again due to inflation and out-performance by companies, leading to ODI rewards. It thought this would raise some interesting questions.

## **Customer Challenge Groups**

16. CCWater said that it had been represented on all of the Customer Challenge Groups (CCGs) that were set up at the beginning of the last price review, and in some instances it had chaired them. On all groups, CCWater's role was to

represent customers, and it had helped make sure that companies produced plans which were grounded in evidence of customers' priorities. CCWater also challenged elements of the price review methodology and ensured that companies tested their plans for customer accessibility. When Ofwat published its draft determinations, CCWater had also tested this for customer acceptability. CCWater also said that it had helped ensure that the results from companies' customer research were interpreted correctly and the research questions were not leading.

17. CCWater said that the 2014 price review had formalised what it had been trying to do in the 2009 price review, which was to make customers central to the process. CCWater thought that the CCGs had helped with this as they had brought more people into the customer engagement process. However, on the whole the CCGs were made up of stakeholders, not customers, but they had helped to reinforce the customer argument using customer evidence. CCWater said that it had provided some comparative data to the CCGs, and this had been vital as without it, they may have just accepted a company's position too easily.
18. CCWater said it would continue to be involved in every Customer Challenge Group.

### **Valuable comparators and innovation**

19. CCWater said that Bournemouth was at, or near to, leading edge in a number of measures like customer satisfaction with value for money, complaint performance, leakage and supply interruptions.
20. CCWater said that SWW had been recognised across the industry for innovation in catchment management approaches for dealing with pollution problems. It had also introduced some effective methods of assisting customers with affordability issues through its Re-Start scheme that had been used to incentivise customers who had fallen into arrears with payments.
21. CCWater said that during the last price review, SWW had received 'enhanced' status for its business plan, along with only one other company, and had included innovations like its WaterShare mechanism for sharing outperformance benefits with customers.
22. CCWater said that there was no correlation between small companies being better performers or vice versa. However, smaller water-only companies did tend to be better at handling complaints. Therefore, it thought that having a small company as a comparator did tend to benefit the whole industry because of its relative complaint and service performance.

23. CCWater said that the small company premium included in the Ofwat set cost of capital was now an added cost to customers that was no longer necessary as the company ownership had changed and it was now a different entity. However, in terms of performance, CCWater felt that smaller companies did have the potential to perform well because of their size and their relationship with the community they served. It specified that the size of the company was not really what mattered, but rather its performance history and management.
24. CCWater said the benefit of having comparators was that it caused companies to want to outperform each other. However, it thought that some of the companies just tried to remain in the middle and avoid being at the bottom, so if the number of comparators reduced, the situation may become un-dynamic.
25. CCWater said customers liked to compare their water company with others and that companies themselves also compared their performance against others.
26. CCWater said that having a league table of companies encouraged improvement in those companies who wanted to improve as they wanted to leapfrog others. It also said that the leaders were not standing still, but were improving from an already superior performance and others were trying to move into the top quartile. CCWater said that it had seen real performance improvements due to its praising or criticising of companies. Therefore, it thought the identification and adoption of best practice was a result of companies being able to compare, but it did not think that this was an example of Ofwat spreading best practice itself, but rather providing an environment for best practice to be identified and spread.

## **The merger**

27. CCWater said it was not against mergers, provided any detriment to the regulatory system or customers could be mitigated. It said it would be concerned if the newly-merged company was looking to cut back on some costs to get efficiency benefits and then these resulted negatively in operational performance and on customer service. It said it supported mergers as they put pressure on management and, in principle, produced cost savings that were potentially beneficial to customers.
28. CCWater also said that if efficiency savings were achieved through a merger, it was important that these were shared with customers immediately and not only at the next price review. It also wanted to see performance levels for the two companies reported separately to give transparency to both sets of customers.

29. CCWater said the main benefit of the merger would be a financial one, especially if Bournemouth's customers did not have to continue to pay the small company premium. It did not think that Bournemouth should continue to benefit from the premium for the next four years now that it was part of a bigger entity. It also thought there would be an operational cost saving. However, CCWater thought the real benefit could be if the service to SWW's customers improved because of the adoption of practices that could lead to SWW matching Bournemouth's levels of performance.
30. CCWater said it had discussed the merger with Pennon, but not all of its concerns had been addressed as it still queried how Pennon would produce the merger savings by merging the call centres and systems, but also retain the high customer service satisfaction for complaint handling that Bournemouth was known for.
31. CCWater was also concerned that if Bournemouth's performance data were added to SWW's, it would diminish the overall comparators across the industry, and it stated that losing a top-performing company as a comparator would not be good because it would narrow the range between companies.
32. CCWater said that Bournemouth's customers might be concerned that they were being taken over by a company that was known to be quite expensive. This was the reason why CCWater believed that prices needed to be set separately.