'Happy Tree – Full Moon Party' Created by Mary Price

Post Provisional Findings Hearings: Bristol Water comments and input on new issues raised

We have reviewed the main party transcripts provided on the 10th December 2020 and provide comments on new issues raised.

We wish to make two overall observations on the transcripts:

- Ofwat make a number of new statements with respect to Bristol Water's size and CSA research. The statements made on the nature of the research are incorrect and have the potential to mislead.
- We have no comments to make on the other company hearing transcripts. We note that in the Northumbrian hearing there was a very clear discussion on the limitations of APR debt data that Ofwat have now analysed without the full debt submission last collected as part of PR19. There was also a clear discussion on the impact of EIB debt on whether water company debt costs may have an outperformance wedge compared to iBoxx historically. We covered at our hearing that EIB debt was/is not available to water only companies such as Bristol Water, as well as the limitations of RCFs which in APR data are within floating rate debt. As we set out in our comments on Ofwat's Response to the Provisional Findings, Ofwat's analysis of this APR data reveals no useful information about the cost of embedded debt appropriate for Bristol Water.

We had no points to clarify on our hearing or its transcript at this stage.

Annex 1: Comments on new issues raised within the post PF hearings

Ofwat Transcript Reference (Page.Line)	Issue	Bristol Water comment	Reference to previous Bristol Water submissions
First Ofwat hearing (30 November)			
Page 7 line 14	Ofwat raise a new issue that some companies have asked Ofwat to reopen PR19.	This is not relevant, as it is not part of the regulatory framework to be able to reopen PR19 once the final determination is accepted	N/A
Pages 11 to 17	[redacted] sets out the historical (before 2014) view of an industry focus on financial performance rather than customers and excessive returns	None of this applied to Bristol Water.	BW Statement of Case, Annex 4, paragraph 54
Page 19 line 18	[redacted] raises the issue that Ofwat on debt should set a benchmark that is independent of companies, and also worries about creating a windfall gain for companies	There is no prospect of a windfall gain for Bristol Water based on the Ofwat approach, which continues to ignore the embedded debt of companies like Bristol Water.	BW Statement of Case, from paragraph 214
Page 21 line 18	[redacted] raises the new issue that £17billion of company debt comes from the EIB, so this builds in outperformance	This contention on the use of a 20 year trailing average overstating the cost of debt therefore cannot apply to Bristol Water. EIB debt is heavily weighted to wastewater and is not available for a small company like Bristol Water (Bristol Water hearing transcript page 17 line 6).	N/A
Page 65 line 22	[redacted] raises the issue that companies filled half of the 15% leakage improvement gap (7%) in one year	This is a reduction from a position where the industry had higher leakage than expected after the “Beast from the East”. In any case, the 15% reduction is reset to account for the actual AMP6 outturn, including this 2019/20 reduction, although the cost of delivering this would not be.	BW Response to CMA Provisional Findings, Annex 1
Page 70	Ofwat state that “Most recently, we have seen evidence that it can raise debt efficiently”, with a foot note that states “Bristol subsequently clarified that this meant at comparable prices to WaSCs”.	Was this footnote something that Ofwat subsequently clarified and inserted following the hearing? Our evidence was not that it was at comparable prices to WaSCs. Rather the evidence we presented is that it is higher than for WaSCs, once controlled for timing, tenor and rating.	Bristol Water response to CMA Provision Findings, Section 12

Ofwat Transcript Reference (Page.Line)	Issue	Bristol Water comment	Reference to previous Bristol Water submissions
Page 72 line 7	Ofwat raise the new issue that customer research on the value of Bristol Water cannot be relied on because "there are lots of flaws with willingness-to-pay evidence. Quite often you get the scenarios where customers are happy to reel off a long list of things that they are willing to pay for with the problem that once you add up all of those different cost items, they sum to more than customers' income."	First, the customer research being discussed here is not based on the willingness to pay approach Ofwat are describing – it was focussed specifically on the topic of the trade off between the additional cost of finance for a small company and the wider benefits customers may or may not see. It had strong academic findings as established in the EY report "The Value of small water only companies" (https://www.bristolwater.co.uk/wp-content/uploads/2018/08/260518-The-Value-of-Small-Local-Water-Only-Companies-EY-Final-Report.pdf) Second, there is no willingness to pay research carried out by Bristol Water at PR19 that could be categorised in the way described in any case. Third, the use of willingness to pay evidence is limited to Ofwat's "customer benefits" test. Taken at face value this statement undermines Ofwat's continued position on the use of this test, which the CMA has not needed to review in detail during the redetermination process.	BW Reply to Ofwat's Response to our Statement of Case, Section 6.2
Page 72 line 18	Ofwat also consider that Hafren Dyfrdwy has maintained local identity as a result of the merger with Severn Trent	The factual evidence supports the opposite conclusion to the point raised by Ofwat. Whilst a local identity may have been maintained, this is not evidence as to whether customers have lost the benefits that customers served by Bristol Water see. The merger was extremely controversial at the time. https://www.bbc.co.uk/news/uk-wales-north-east-wales-38906186 The merger also result in a high number of customer complaints. Ofwat's recent service delivery report placed Hafren Dyfrdwy as a "Poorer performing" company https://www.ofwat.gov.uk/wp-content/uploads/2020/12/Service-delivery-2020-final-1-	N/A

Ofwat Transcript Reference (Page.Line)	Issue	Bristol Water comment	Reference to previous Bristol Water submissions
		Dec.pdf, as has CCW's complaint handling report. https://www.ccwater.org.uk/wp-content/uploads/2020/09/Review-of-water-companies-complaint-handling-2019-20.pdf Customer complaints increased following the merger and have stayed relatively high. We would note that Ofwat have previously categorised Bristol Water as a poorer performer, but changes as a result of the transformation in Bristol Water which we believe are linked to the agility of a smaller local water company (coinciding in time with the Dee Valley/Severn Trent merger and the creation of Hafren Dyfrdwy), have seen significant improvements for customers.	
Page 85	Ofwat raise a new argument on financeability – that if you set the cost of debt too high then this causes a financeability constraint.	Whilst this may theoretically be the case, this is unlikely to apply where the notional gearing at 60% is below the typical level in the industry. In any case, a financeability assessment will also consider the actual company structure and debt as a cross check (as carried out through debt headroom and through downside scenario analysis). In the case of Ofwat's FD for Bristol Water, the financeability error made by Ofwat cannot be explained away with this new Ofwat position. The unweighted gearing average for the sector in 2019/20 is c71%, with only one company below 60%. The listed companies are 65% - 67%, compared to 68% for BW (66% excluding preference shares.	N/A
Second Ofwat hearing (2 December)			

Ofwat Transcript Reference (Page.Line)	Issue	Bristol Water comment	Reference to previous Bristol Water submissions
Page 22 line 11	Ofwat appear to make a new argument that an appropriate benchmark for higher performing companies on leakage may be the 2024/25 upper quartile.	We cannot understand the logic of this argument. The issue is related to the sufficient of leakage in base models. It may be possible that Ofwat have conflated costs with leakage targets, but clearly if imposing a higher benchmark target, this affects the base costs, without reducing enhancement costs. If there is a rising marginal cost of base and enhancement leakage (controlling that companies with lower leakage may be more efficient), then a higher cost allowance should be made (which leakage modeling, such as undertaken by PWC for Ofwat, demonstrated alongside the other evidence we have provided).	BW Response to CMA Provisional Findings, section 16.