CUSTOMER CHALLENGE GROUP OF SOUTH EAST WATER: FURTHER SUBMISSION TO OFWAT ON THE COMPANY'S BUSINESS PLAN FOR 2015-2020

27 June 2014

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SUMMARY

Introduction

The CCG was pleased to see that the business plan of SEW had scored quite highly in the Ofwat risk-based review with 4 As, 14 Bs, 11 Cs, and no Ds.

The CCG has taken the view that most of the areas on which the Company has now revised its business plan are not ones on which we are qualified or required to comment. However, we believe that we should comment on performance commitments, outcome delivery incentives (ODIs) and affordability and therefore these three subjects are the focus of this supplementary submission. We have also included a short comment on cost of capital, in the context of the case for a small company premium, since this has been the subject of some discussion with the CCG.

Performance Commitments

Having reflected further on these matters, the CCG is still of the view that SEW has chosen both the right outcomes and appropriate performance measures. However, we can understand Ofwat wishing to understand better how these commitments have been allocated between the retail and wholesale businesses respectively.

Outcome Delivery Incentives

Given the CCG reservation on the original SEW ODI regime as expressed in our earlier submission to Ofwat, we welcomed the regulator's requirement in its risk-based review that the Company needed to do more work on its ODI package.

SEW's research for its original business plan, the business plans submitted by companies in December 2013, and CCWater research on customer views on ODIs published in March 2014 all suggested that customers struggle with the whole concept of risk and reward and are particularly sceptical about the notion of financial reward, even for exceptional performance.

By contrast with 59% who previously opposed higher bills for improved performance in earlier SEW research, both waves of the more recent SEW research found that a majority – 61% and 60% respectively - of respondents thought it *"a good idea"* to link water bills to the performance of the Company. We have expressed some reservations about the extent to which customers support a linkage between bills and performance, but studied carefully the revised ODI package.

From the point of view of the CCG, the important points are that:

- Taken overall, the maximum penalty has been increased from £10.2 million to £45.6 million over the five years.
- Taken overall, the maximum reward has been increased from £1.2 million to £31.7 million over the five years.
- Taken overall, the maximum penalty has been maintained at -1% of RORE which is within the Ofwat guidance.

- Taken overall, the maximum reward has been increased from +0.6% of RORE to +1% of RORE which is within the Ofwat guidance.
- For the customer, the maximum bill increase has risen from £1.44 a year to £5 a year.
- For the customer, the maximum bill decrease has risen from £2.45 a year to £5 a year.
- These increases in risk and reward appear to be consistent with the Company's earlier research on Willingness To Pay in that those results showed overall WTP for the intermediate service level improvements was +£12.01 for household customers.
- To the best of our judgement, the revised ODI risk and reward regime appears to work as a package.

Looked at overall, we can see that the revised ODI package is likely to offer a better deal for customers if it drives significant performance improvements but, given how small the resultant possible bill changes are (both in cash and percentage terms), we wonder whether the effort and cost in revising the package is proportionate to the likely impact on the bill. It might be that the ODI package has a greater incentive effect on SEW management than the impact it has on the bills of the Company's customers, but we will not know that for several years.

Affordability

New research has been conducted to ascertain if customers really understand the likely future cost of the Thames Water sewerage bill, taking account of the Thames Tideway Tunnel (TTT), and to assess what impact this has on the overall acceptability of the total water and sewerage bill.

The research has demonstrated that the sewerage element of the bill, for which Thames Water is responsible, clearly has the effect of reducing substantially the acceptability of the overall bill. This reduction in acceptability of the total bill has been quite dramatically increased when one compares SEW's original acceptability research for the business plan submitted in December 2013 with the new acceptability research featuring the updated information on the TTT.

Once informed with more details, 77% of household customers in the Thames Water area found the overall business plan acceptable or completely acceptable compared to 86% covering the whole Company area in the original research. [As a like for like comparison, it is 77% of Thames Water customers in the second piece of research compared with 82% of Thames Water customers in original research.]

It looks as if, the more sewerage customers of Thames Water learn about the costs of the TTT, the more they are concerned about the impact on their future bills. While this is primarily a problem for Thames Water, since around a third of SEW's customers are impacted and SEW is the bill provider for those customers, it seems inevitable that there will be an impact on SEW's billing, debt recovery and customer call centre operations. We believe that clear customer communication is going to be vital and SEW has assured us that it recognises the requirement for a joined up engagement programme.

Cost of capital

The CCG understands the importance to SEW that the Company should be accorded a small company premium (SCP) and appreciates that it will be submitting a case for this to be retained in 2015-2020.

At our last CCG meeting, we discussed with the Company whether there should be any specific customer research to support the case for a SCP. At that time, we concluded that the issue was likely to be too complex for meaningful customer engagement in the timescale available. We were also aware that the acceptability of the Company's bill proposals was to be the subject of customer research and this did include the reduced cost of capital and the Company's suggested SCP. The outcome of this research would, therefore, to some extent reflect customer views on the whole business plan package including the SCP proposed by SEW.

The results of this work show a reasonably high level of acceptance at 71%.

Since finalising this report, SEW has informed the CCG that it has undertaken four regional focus groups on this subject, The CCG has not seen the material or results and therefore it is unable to comment on it.

INTRODUCTION

On 2 December 2013, South East Water (SEW) submitted to Ofwat its proposed business plan for 2015-2020. On the same date, the Customer Challenge Group (CCG) of SEW submitted to the regulator its critique of the Company's proposals.

On 4 April 2014, Ofwat published the result of its risk-based review for all those companies – which included SEW – which had not earlier been offered enhanced status.

The CCG was pleased to see that the business plan of SEW had scored quite highly in the risk-based review with 4 As, 14 Bs, 11 Cs, and no Ds.

Ofwat set out in its review that enhanced status had not been offered because more evidence was required in relation to various tests. Following conversations with Ofwat on SEW's business plan categorisation, the Company has advised the CCG that it will submit further information to the regulator on the following topics:

- Performance commitments
- Wholesale cost assessment
- Legacy adjustments
- Average cost to serve adjustments
- Affordability
- Board assurance
- Weighted average cost of capital
- Outcome delivery incentives
- Return on regulated equity analysis
- Cost allocation update

The CCG has taken the view that most of these are matters on which we are not qualified or required to comment, but we believe that we should comment on performance commitments, outcome delivery incentives (ODIs) and affordability and therefore these three subjects are the focus of this supplementary submission. We have also included a short comment on cost of capital, in the context of the case for a small company premium, since this has been the subject of some discussion at the CCG.

HOW WE HAVE WORKED

Since our submission to Ofwat on 2 December 2013, the CCG has remained fully operative (except that the Drinking Water Inspectorate has ceased to nominate a representative to our deliberations). We have had three further CCG meetings including one that discussed this supplementary submission in draft.

Additionally the Chair has had regular meetings with the Company to discuss the content of Ofwat's business plan categorisation and the further work and thinking of the Company in relation to its Early Information Sharing of 19 May 2014 and its final complete submission on 27 June 2014. The Chair also acted as independent presenter at an innovative webinar with SEW customers to discuss affordability and

ODI issues. Finally, in between the last CCG meeting and the date for the final complete submission, the Chair attended a meeting (his fifth) with the SEW Board to discuss a draft of this supplementary submission.

In addition to these meetings, CCG members have received regular electronic communications from the Company, especially on the methodology and findings of further research on the outcome delivery incentives regime.

Throughout this extensive process of dialogue between the CCG and SEW, our representations have been captured in a new Challenge Log which eventually recorded 76 challenges. This Challenge Log is an attachment to this supplementary submission. In this covering note, we highlight the most significant and substantial of these challenges and, where appropriate, we have referenced specific challenges by number.

Throughout this further process of dialogue, we have been concerned at the complexity of the issues being researched with customers and the methodological uncertainties involved in any piece of customer research.

On the complexity issue, we have urged SEW and Accent to use language that the customer can understand and made a whole series of suggestions on specific pieces of text. The Company feels that it has responded to these challenges, but the CCG believes that some jargon still remains. Ultimately it is mainly the complexity of the subject matter that is the problem.

We would remind Ofwat of our comment in our first submission on the SEW business plan when we noted:

> *"We have set out some of our reservations about the WTP methodology and contrasted the stated preference approach as compared to the revealed preference approach. Furthermore we have felt that there were times when customers were asked in research to comment on issues that they really could not meaningfully comment on e.g. pace of change (in the online panels), effectiveness of water resource options (in the WRMP focus groups), and WTP linked to changes in* satisfaction (in the outcomes research)."

On the uncertainties issue, we asked the Company to add confidence levels to the figures emanating from the new research. This will help us to understand whether these differences reflect a real difference between the surveys or are probably just due to the variability in the population. We were pleased to see that confidence intervals at the 95% level for key statistics are shown throughout the final reports.

PERFORMANCE COMMITMENTS

In our first submission to Ofwat on the SEW business plan, we noted on outcomes:

> ***"****We believe that SEW has selected around the right number of outcomes and more importantly chosen the right outcomes, that is the ones that matter most to its customers as evidenced by its research. Ofwat should be supportive of the outcomes chosen by SEW for its business plan, since these are clearly supported by customer research and, in the view of the CCG, address all the key issues of importance to customers."*

As regards performance measures, we noted:

> *"The CCG was sympathetic to SEW's aspirations early in the planning process to measure these outcomes wholly in terms of customer perceptions as this would clearly demonstrate outcomes and not outputs. We were anxious, however, about whether it would be possible to develop in time proper measures for such perceptions and can understand why in the end the Company has chosen to use a mixture of actual service measures and perception measures.*
>
> *The concept of combining actual measures (many with shared responsibility between the retailer and the wholesaler) and an on-going measure of customer satisfaction is a good one and does provide focus for both elements of the business."*

Having reflected further on these matters, the CCG is still of the view that SEW has chosen both the right outcomes and appropriate performance measures. However, we can understand Ofwat wishing to understand better how these commitments have been allocated between the retail and wholesale businesses respectively.

We noted that the Company's Early Information Sharing paper explains clearly how the Company has allocated performance commitments between the retail and wholesale businesses. It is notable that, in 7 cases out of 13, "management expertise" has been utilised. We suggested that it would be useful for more information to be given in each case so that the decision does not look too subjective or arbitrary [Challenges 11, 51, 64]. We note that more information and an example has been provided in the Company's final submission.

OUTCOME DELIVERY INCENTIVES

In our first submission to Ofwat on the SEW business plan, we noted:

> ***"****To construct a total incentive around this approach to outcome delivery incentives (ODIs), SEW has used Return on Regulatory Equity (RORE) as a tool and analysis by Frontier Economics to develop that tool. This has resulted in an incentives package for the business plan from -£10.2M (which would represent -1%) to +£1.2M (which would represent +0.6%) a year. This represents an asymmetry between penalties and rewards but that reflects a similar asymmetry in the SIM measure.*
>
> *The CCG notes that, from the point of view of customers, this incentives regime would represent a maximum 'return' of around £2.45 per customer per year in the event of the failure to achieve all the targets and a maximum bill increase of £1.44 per customer per year in the event of beating all the targets. In the context of a bill of £199 in 2012/13 prices, this would be a maximum decrease in the bill of around 1.23% or a maximum increase in the bill of 0.73%. In practice, any decrease or increase might be smaller.*
>
> *We do not know how customers would view such a regime as this has not been tested in detail with customers and we are not sure that these levels of change would be noticeable by them. However, we have been assured by the Company that the reward/penalty range is comparable to the current SIM mechanism and that this has been shown to be effective in changing the Company's behaviour. So the CCG concludes that such an ODI package would benefit customers but not in a manner that they would directly notice in their bills.****"***

Given the CCG reservation on the original SEW ODI regime, we welcomed Ofwat's requirement in its risk-based review that the company needed to do more work on its ODI package.

As we understand it, in assessing SEW's business plan Ofwat has offered the following guidance:

- a wider financial range for the risk and reward package
- that range to be between +/- 1-2% of RoRE
- more use of financial incentives rather than simply reputational incentives

However, SEW's research for its original business plan, the business plans submitted by companies in December 2013, and CCWater research on customer views on ODIs published in March 2014 all suggested that:

- customers struggle with the whole concept of risk and reward
- customers are particularly sceptical about the notion of financial reward, even for exceptional performance
- customers do not expect the company to obtain a financial reward simply by meeting its compliance obligations
- customers do not expect the company to obtain a financial reward simply by hitting an undemanding performance target
- customers are not so troubled by the notion of penalty but expect it to be at a

level which has an impact on company performance

This understanding of customer views led to what Ofwat has described as *"a relatively conservative approach to ODIs, with relatively few instances of financial rewards, and relatively modest financial penalties".*

In reconciling these somewhat different views, we have noted Ofwat's comment in its risk and reward guidance that customers have been influenced by the way the engagement on ODIs has been framed:

"We appreciate that the development of ODIs and their incentive mechanisms has involved substantial work by companies and CCGs, and the development of incentives involves complex issues with a wide range of impacts, some less visible than others. Although we recognise the importance of the views expressed on financial incentives, we have concerns about the way in which these discussions were framed.

In particular, we have seen no evidence that companies explored packages, or trade-offs, involving a lower base cost of capital in return for the opportunity to earn meaningful additional rewards through outperformance. Also, in the context of the individual company-proposed ODIs, we are concerned that there had been insufficient effort to explain, in a balanced way, the potential for rewards and win–win benefits sharing."

We can understand Ofwat concerns about how discussions on ODIs have been framed. This is a complex topic for consumers and, if not explained carefully, could lead to a lack of understanding that encourages aversion to the concept. However, we are equally aware that a reframing of the conversation – especially if seen as a requirement of the regulator – could lead to a construct of research that tends to lead customers to a position believed to be more acceptable to the regulator.

Therefore, in further discussions between the CCG and SEW on the Company's revised ODI package, we have recommended:

- the conduct of further research to clarify customer views on the notions of risk and reward [Challenge 12]
- the use of clear language and understandable options in this further research through a whole series of detailed suggestions [Challenges 13-47]
- comparison and consistency with the ODI packages of the enhanced companies Affinity Water and South West Water [challenge 61]

We have taken the view that, to the extent this is supported by the new customer research:

- There should be an increase in both maximum penalty and maximum reward [Challenge 9].
- Any such increase in risk and reward should, as far as possible, be consistent with the Company's earlier research on Willingness To Pay (WTP) [Challenge 9].
- Risk and reward need not be symmetrical, since Ofwat has given no guidance on this and the packages of the two enhanced companies are asymmetric.

The further research on risk and reward commissioned by SEW has revealed a rather different picture than was originally the case. The original research suggested that 53% of households supported lower bills in the event of falls in customer satisfaction but 59% of households opposed higher bills in the event of improved satisfaction.

The further research was in two waves testing different ODI packages.

It should noted that SEW tested first £189 and then £201 as the average bill in order to provide a range while the Company was modelling the new bill. Since the final bill has come out at £196, we can infer from the two pieces of research that acceptability of a bill of £196 would be between 74% and 88%.

By contrast with 59% who previously opposed higher bills for improved performance, both waves of the more recent research found that a majority – 61% and 60% respectively - of respondents thought it *"a good idea"* to link water bills to the performance of the Company. While this consistency may be encouraging, we have a number of reservations about these figures that lead us to take the view that this may not such a strong endorsement for the principle of linkage.

First, the figures are the result of what could be seen as a leading question [Q14a stated: "Do you think it is a good idea to link water bills to the performance of South East Water?"] and it would have been much better for the question to have been worded more neutrally [for instance, "Do you think it is a good idea or a bad idea to link water bills to the performance of South East Water?"]. Second, the figures do not represent a substantial majority with just six in ten suggesting they back linkage before they have been presented with scenarios illustrating the implications of such linkage. Third, more than a quarter of respondents (28% and 29% respectively) admitted that they were unsure or did not know – a high proportion, suggesting that either many respondents did not understand the concept of linkage sufficiently to give an opinion and/or they did not have a view about whether performance should be linked to bills.

Turning to specific scenarios for possible changes in the bill and comparing the second wave with the first, the new research found the following:

- Participants rated scenario A (£196 - planned average bill minus £5) as 30% acceptable (23% 'Acceptable'; 7% 'Completely acceptable') compared to 36%.
- Participants rated scenario B (£201 - planned average bill) as 74% acceptable (64% 'Acceptable'; 10% 'Completely acceptable') compared to 88%.
- Participants rated scenario C (£206 - planned average bill plus £5) as 77% acceptable (58% 'Acceptable'; 19% 'Completely acceptable') compared to 77%.
- Participants rated scenario D (£212 - planned average bill plus £11) as 64% acceptable (50% 'Acceptable'; 14% 'Completely acceptable') compared to 71%.

What are we to make of these findings?

It seems that scenario B – a stable bill – was markedly less acceptable (88% in the first wave but 74% in the second) when the planned average bill was raised from £189 in the first wave to £201 in the second. The second wave scenarios presented more specific information about the targets, including the current service level position, and this seems to have made scenarios A and D less acceptable, but strangely appears to have made no difference in relation to the acceptability of scenario C.

The CCG is not surprised at the lack of customer support for scenario A: 39% stated that service levels should not fall and a further 10% said that service levels should be maintained which is the same thing. Customers clearly value highly current levels of service.

But we are surprised at the high levels of acceptability found for scenarios C and D (we note that apparently acceptability of C which involves higher prices is even higher than that of B which involves stable prices). We wonder whether the more detail given to customer on improved service levels has led them to *say* that a higher price in return for better service is a reasonable trade-off when in practice most of them want stable prices and present levels of service.

Overall the CCG reaffirms its concern that selecting between such scenarios is really challenging for customers. When asked in the surveys, if they were comfortable in assessing the scenarios, in the first wave only 40% said that they were and in the second wave a bare majority of 55% said that they were. This is a large difference between very similar surveys that is not explained. In the two waves of research, many respondents said that “Mostly I could do this” – 48% in the first wave and 33% in the second wave. We do not know in what way and to what extent these respondents felt less than totally comfortable in making choices.

The outcome of the further research and further thinking by the Company is that, of 26 performance measures, 12 have changed. The details are in the SEW final submission to Ofwat and do not need to be repeated here.

From the point of view of the CCG, the important points are that:

- Taken overall, the maximum penalty has been increased from £10.2 million to £45.6 million over the five years.
- Taken overall, the maximum reward has been increased from £1.2 million to £31.7 million over the five years.
- Taken overall, the maximum penalty has been maintained at -1% of RORE which is within the Ofwat guidance.
- Taken overall, the maximum reward has been increased from +0.6% of RORE to +1% of RORE which is within the Ofwat guidance.
- For the customer, the maximum bill increase has risen from £1.44 a year to £5 a year.
- For the customer, the maximum bill decrease has risen from £2.45 a year to £5 a year.
- These increases in risk and reward appear to be consistent with the Company’s earlier research on Willingness To Pay in that those results showed overall WTP for the intermediate service level improvements was +£12.01 for household customers.
- To the best of our judgement, the revised ODI risk and reward regime appears to work as a package.

The CCG notes particularly that, in the case of two performance commitments – leakage and average interruption time (both important to customers) – SEW has moved from a reputational incentive to a penalty and reward approach. But we are pleased that there remain no financial incentives in relation to compliance outcomes. We note that SEW has committed to work with Ofwat and the Environment Agency to establish a robust and meaningful performance commitment in relation to the Company's impact on the environment.

Looked at overall, we can see that the revised ODI package is likely to offer a better deal for customers if it drives significant performance improvements but, given how small the resultant possible bill changes are (both in cash and percentage terms), we wonder whether the effort and cost in revising the package is proportionate to the likely impact on the bill. It might be that the ODI package has a greater incentive effect on SEW management than the impact it has on the bills of the Company's customers, but we will not know that for several years.

AFFORDABILITY

SEW commissioned Accent to do further research on the acceptability of bills as part of the research on a new ODI package. In commenting on the top line findings, the CCG observed:

- Earlier research questioned customers on the acceptability and affordability of bills, so we asked that Accent include in the final report a comparison of the previous findings with the current findings [Challenge 48].
- We noted that 54% stated that the current bill was too much, but 75% said an increase of £5 would be acceptable and 71% said an increase of £10 would be acceptable given certain improvements in service. We asked how Accent or SEW reconcile these two sets of findings [Challenge 49].
- We noted that the original Willingness To Pay research showed little if any appetite for higher bills in return for improved service, but the latest research suggests that even an increase of £20 would be acceptable to a (bare) majority in return for specified service improvements. We asked how Accent or SEW reconcile these two sets of findings [Challenge 50].

The CCG noted that, in its risk-based review of SEW's original business plan, the regulator stated:

> ***"****The company has presented evidence that the range of support measures for customers with affordability problems is appropriate, including a plan to introduce an affordability tariff in 2015. However, we do not think it has engaged appropriately with customers on bills for 2015-20. While South East followed an engagement approach for affordability which had many aspects that were well-structured, the way it presented its sewerage bills, especially for Thames Water, was not clear. We consider that the result that the information of a large increase in sewerage bills has little impact on the acceptability of the water bill evidences an issue in the research. The company has not shown evidence it has considered this counter intuitive result."*

This comment surprised the CCG a little since SEW's original research did specifically mention the Thames Tideway Tunnel (TTT) and used wording provided by Thames Water itself. We wondered whether any further research would use the same information (and, if not, why) and result in the same findings (and, if not, why).

Nevertheless, given this comment by Ofwat, the CCG understood why SEW would want to commission further research on the acceptability of bills, but the timetable for this research has been tight and the findings were not available at the time of our last CCG meeting. However, we have commented to the Company that, given that SEW regarded its acceptability research as robust but was now going to do some further research around the impact of the TTT, the supporting commentary should make clear exactly why this further research was carried out and how it was different from the previous research [Challenge 55].

Furthermore we have queried the nature of the revised numbers and text used in relation to the TTT in the further affordability research. We have been advised that the revisions to the sewerage bill are *"not material"* but, looking at the original and revised wordings, it seems to us that the revised wording does make clearer both the amount and the timing of the increase due to the TTT [Challenge 62].

The final findings of the new research confirm our expectation that the revised wording would make a significant difference:

- 72% of household customers found the business plan acceptable or completely acceptable when presented with the South East Water plan and bill impact
- 49% of household customers found the business plan bill impact, including sewerage company information, acceptable or completely acceptable
- 77% of household customers found the overall business plan acceptable or completely acceptable, once informed with more details

What are we to make of these findings?

The water element of the bill, for which SEW is responsible, has a good level of acceptability. CCWater commissioned SPA Future Thinking to do research on the appropriate level of bill acceptability and the acceptability threshold that most customers spontaneously cited was 70-75%. So the SEW part of the bill falls in this threshold.

However, the clearer information on the sewerage element of the bill, for which Thames Water is responsible, clearly has the effect of reducing significantly the acceptability of the overall bill. This is shown by comparing SEW's original acceptability research for the business plan submitted in December 2013 with the new acceptability research featuring the revised information on the Thames Tideway Tunnel.

Once informed with more details, 77% of household customers in the Thames Water area found the overall business plan acceptable or completely acceptable compared to 86% covering the whole Company area in the original research. [As a like for like comparison, it is 77% of Thames Water customers in the second piece of research compared with 82% of Thames Water customers in original research.]

It looks as if, the more sewerage customers of Thames Water learn about the costs of the TTT, the more they are concerned about the impact on their future bills. While this is primarily a problem for Thames Water, it has significant implications for SEW as their billing agent. Although SEW can do nothing to influence the sewerage bill, it will need to plan for the potential impact this will have on its billing and call centre operations.

We believe that clear customer communication is going to be vital and SEW has assured us that it recognises the requirement for a joined up engagement programme. The CCG notes that, since satisfaction represents a considerable component of the SEW ODIs, a significant incentive will exist for the Company to ensure that this engagement is effective.

COST OF CAPITAL

As a fundamental part of the PR14 process, Ofwat has determined that the vanilla weighted average cost of capital (WACC) should be 3.85%.

We noted that this is lower than the figure used by every company in its business plan as submitted to the regulator in December 2013. We wonder why all 18 companies reached a different figure from Ofwat and whether it would have been helpful for the regulator to make clear its decision before submission of business plans but, in this supplementary submission by the CCG, our particular concern is that South East Water is a small company but so far the case for a small company premium (SCP) has not been agreed by Ofwat.

The CCG understands the importance to SEW that the Company should be accorded a SCP and appreciates that it will be submitting a case for this to be retained in 2015-2020.

We did discuss with SEW whether there should be any specific customer research to support the case for a SCP. We concluded that the issue was probably too complex for meaningful customer engagement in the timescale available. Furthermore, as the acceptability of the bill was to be subject of customer research and this involved a bill profile that included the company's proposed SCP, this would be sufficient to demonstrate customer support or otherwise for the business plan as proposed by SEW. The results of this work show a reasonably high level of acceptance at 71%.

In fact, subsequently, the SEW Board decided to commission some qualitative research in the form of four regional focus groups, not to discuss the SCP construct itself but to ask about the upside of being supplied by a local small company both in terms of performance and cost. There was no time for us to be involved in the design of this research or to consider its findings.

CONCLUSION

As a result of its frequent and detailed dialogue with the Company, the CCG believes that SEW has tried to follow the spirit as well as the letter of Ofwat's guidance through the risk-based review and has endeavoured to stay true to the findings of the customer research in its reworking of its business plan.

Therefore we hope that Ofwat will feel able substantially to endorse the revised business plan and look forward to the regulator's Draft Determination for the Company.

Of course, the CCG is very conscious that approval of the plan and determination of prices is the start of what customers can expect in 2015-2020 and far from the end. Actual implementation of the plan and fulfillment of the performance commitments are what matters to customers.

In that regard, we reaffirm our support in our original submission for the Customer Panel proposed by SEW in its original business plan. Again we would urge SEW to consider how the work of the current CCG might feed into the new Customer Panel and how subsequently the work of the Customer Panel might in turn feed into any future CCG-type body focusing on PR19 [Challenge 54].

CCG Comment Tracker	27/06/2014

Item	Raised By	Date Raised	Subject Matter	Comment/ Feedback/ Challenge	Response
1	Roger Darlington	05/04/2014	Business Plan resubmission	As I understand it, the Board will decide on 14 April whether to go for the faster or slower timetable of submission of a revised plan to Ofwat. If the decision is to go for the faster timetable - as I think the company could and probably should do - there will only be three weeks to 2 May when the company has to submit its plan and the CCG has to submit its report. This period includes Easter of course. So I am wondering if you can advise me now or if Tanya can advise the CCG at its meeting what processes and timings SEW will deploy to ensure that CCG members have a reasonable time to study revisions to the Business Plan, discuss them with the company, and produce a supplementary report.	We are working up a fast and slow timetable and will share with you what we think we will change, I think the biggest impact for the CCG is the change to ODIs as we are no envisaging changing the outcomes themselves or the overall spend. We have a number of other elements but they are more pure regulation on for example legacy adjustments that the CCG will be less concerned with. Further to this response the Company has decided to go with the original timetable, this timetable will provide sufficient time to conduct further robust engagement with customers and our Customer Challenge Group, around the revisions to our plan, in particular around any revisions to the ODI package. This time table will also allow us to maintain a high quality plan and an appropriate level of governance.
2	Roger Darlington	05/04/2014	Business Plan resubmission	In my discussions with Ofwat on our prime CCG report, I had the impression that Ofwat felt that the CCG challenges were less transparent in the last couple of months before we submitted our report. I believe that this is because effectively we suspended the Challenge Log, partly because the CCG was making so many comments on so many drafts of the Business Plan and partly because we were all so focused on finalising our respective documents. However, I think that it would be helpful if we now opened a new Challenge Log to apply to the period between now and our respective further submissions to Ofwat. I should like my request in this e-mail and the company's response to be the first entries in this new Challenge Log.	New challenge log created and in place for revisions to the business plan.
3	Roger Darlington	09/04/2014	Continuation/transition of CCG	The Company needs to consider how the CCG will continue or transform into the Customer panels that the company promised to set up in their business plan.	***Awaiting SEW Response***
4	Caroline Farquhar	09/04/2014	Complaints	The company needs to think of a way to show current performance levels, in particular complaints, as not everyone reads the Annual Performance Report i.e. on the home page of the company website.	***Awaiting SEW Response***
5	Karen Gibbs	09/04/2014	ODI	The CCG would like the company to show how changes in the ODI package will effect bills in a clear way.	The impact on customer bills is being estimated based on the impact on revenue. This will be shown in the research being proposed, see challenge response below.
6	Jim Barker	15/04/2014	ODI	I wonder if the evidence provided in Section 4 might lead to people questioning the integrity of ODIs. It seems to show the company historically having very little problem hitting targets and so, satisfaction measures aside, the ODIs look like 'easy money'. I would expect the targets in the ODIs to reflect Ofwat's expectation that they be for exceptional performance and I would expect the company to clearly evidence the context and scale of the targets within the ODI scenario it eventually chooses.	Agree and package being tested with customers will clearly show rewards would only be applicable where performance is better than the plan proposes and only in a case of exceptional performance would the maximum incentive be applied.
7	Roger Darlington	15/04/2014	ODI	As I understand it, in assessing SEW's business plan Ofwat has expressed the following views: • it wants to see a wider financial range for the risk and reward package • it wants that range to be between +/- 1-2% of RoRE • it wants to see more use of financial incentives rather than simply reputational incentives • it expects a rough symmetry as between risk and reward respectively Is this right? Have I missed anything? What exactly is RoRE? How does Ofwat justify the figures 1-2% How does this compare to other regulated sectors with risk and reward regimes?	RoRE stands for the Return on Regulatory Equity and captures the possible range of upside and downside returns arising from the regulatory methodology. The starting point is the traditional approach of allowed profit based on RCV and the cost of capital. RoRE is calculated as follows: RoRE = <u>Regulatory profit after tax – Interest / RCV - Debt</u> Profit after tax = WACC x RCV Ofwat has benchmarked their RoRE range in appendix 4 of the Risk and Reward Guidance published on 27th January.
8	Roger Darlington	15/04/2014	ODI	As I understand it, customer views on ODIs are: • they struggle with the whole concept of risk and reward • they are particularly sceptical about the notion of reward • they do not expect the company to obtain a reward simply by meeting its compliance obligations • they do not expect the company to obtain a reward simply by hitting an undemanding performance target • they are not so troubled by the notion of penalty but expect it to be at a level which has an impact on company performance Is this right? Have I missed anything?	This is right. However Ofwat believe this has been influenced by the way the engagement has been framed, see extract below from the Risk and Reward guidance. 'We appreciate that the development of ODIs and their incentive mechanisms has involved substantial work by companies and CCGs, and the development of incentives involves complex issues with a wide range of impacts, some less visible than others. Although we recognise the importance of the views expressed on financial incentives, we have concerns about the way in which these discussions were framed. In particular, we have seen no evidence that companies explored packages, or trade-offs, involving a lower base cost of capital in return for the opportunity to earn meaningful additional rewards through outperformance. Also, in the context of the individual company-proposed ODIs, we are concerned that there had been insufficient effort to explain, in a balanced way, the potential for rewards and win–win benefits sharing'.

9	Roger Darlington	15/04/2014	ODI	Looking at Table 1, it is clear that the maximum penalty originally proposed was almost a third less than the value of the SIM, while the maximum reward originally proposed was only about two-fifths of the SIM. Therefore I think the CCG can say that it welcomes the company's intention now to increase both the maximum penalty and the maximum reward. However, the paper points out that the proposed increase in the reward package will represent a "disconnect" from the results of customer research. How does the company propose to justify this in its next submission to Ofwat?	The variance of the business plan proposed reward and penalty to the SIM range is due to the phased introduction on the satisfaction measures. If the incentives were in place in all 5 years at their full value it would equal the SIM range. As far as possible we propose to maintain the link to WTP, however as the paper states to reach the range set out by Ofwat it may not be possible to maintain this link. Ofwat has provided further guidance in our meeting with them that where there is not sufficient WTP companies can use cost of service improvements as an alternative to set incentive values. We will be analysing this as part of our revised package development.
10	Roger Darlington	15/04/2014	ODI	The paper looks at four options for a new ODI regime. In terms of overall value of penalty and reward and the symmetry between penalty and reward, there is little to choose between the four options. All of them would represent the lowest threshold for penalty and reward respectively as specified in the Ofwat guidance. One difference, however, is the maximum penalty for meeting demand for water as between Options A and B versus Options C and D. Can we have a fuller explanation of the reasoning behind this? The main difference between the four options is the triggers used to impose penalties or give rewards. From a customer point of view, we would assume that the 'lowest' threshold for triggering penalties and the 'highest' threshold for triggering reward would be the approaches most favoured. But clearly that would maximise the risk for the investors and they would need to be accepting of this. In terms of Ofwat's likely acceptance of a revised ODI package from SEW, the regulator's decisions in respect of the ODI regimes of Affinity Water and South West Water will be instructive. The CCG would welcome guidance from SEW on how its latest proposals compare with the ODI approach of the two companies which have achieved enhanced status.	Maximum penalty and reward for meeting demand for water increases by a multiple of four to £0.9m in scenarios C and D. £0.2m could be viewed as an insignificant value for hosepipe ban levels of service which is why the value has been increased to a significant sum in the last two scenarios. We have reviewed the ODI approach of the two enhanced companies as much as possible, given the information in the public domain. A note outlining their approaches is provided separately. We will bear in mind the approaches of these two companies when finalise our revisions, however it should be noted that customer views may be different and outcomes and commitments will be different.
11	Roger Darlington	15/04/2014	ODI	Finally, once the value of risk and reward have been determined, there is the matter of allocation of the incentives between the wholesale and household retail businesses. Ofwat said in its categorisation of the SEW business plan that it believed that the company "did not provide any detail of how it had allocated outcome delivery incentives". The CCG would like to be assured that the necessary detail is being collated and will be provided in the next submission to the regulator.	We set out how the ODIs would be split between retail and wholesale in Appendix 16 of our submission. We queried this with Ofwat in our meeting and they confirmed they would like more detail on the management exercise used to set the percentage splits. This will be provided in our response.
12	Karen Gibbs	16/04/2014	ODI	Given that there is this question over customers' views on your new ODI proposals (having had some clear feedback on prices etc. from the earlier work) I think there is a research gap that needs to be filled. By thinking about how you would explain all this to customers (in a convincing way) it may help in drafting your submission to Ofwat. They will need convincing that the targets are challenging, are set against the right outcomes/performance commitments, will drive the right company behaviour and deliver demonstrable improvements. Importantly customers will need some reassurance over the impact it could have on bills compared to the earlier approach. I appreciate that the timescale is very tight but it would appear to be an essential part of your submission.	Agree and we have commissioned Accent to complete a piece of research. The draft questionnaire is provided in a separate document, the incentive packages being tested and the estimated impact on bills is shown in the table below.
13	Kathryn Rathouse	22/04/2014	Draft ODI questionnaire	My main concern is that this survey is going to be very challenging for respondents. They are being asked to read and understand a lot of information, much of it very technical. They are also being asked to make some judgements that are likely to be very difficult, either because the judgments are cognitively difficult (e.g. they have to hold a lot of info in their mind) or because they're unlikely to be meaningful to most respondents.	Challenge accepted and taken on board in survey amendments.
14	Kathryn Rathouse	22/04/2014	Draft ODI questionnaire	Can Accent do anything to make the information easier to read and understand, and to encourage respondents to read it? A few suggestions would be to: (a) replace technical terms with lay terms (b) remove any info that isn't strictly essential (c) divide large amounts of information (e.g. 5 paras of text under 'Current Business Plan' on page 4) into smaller blocks (d) include very quick and simple questions partway through large blocks of text to encourage respondents to read/discourage respondents from skipping the text (e) use pictures to make the concepts simpler (e.g. the three options for bill profile were explained with pictures in the SEW customer survey last year, if I remember rightly)	Challenge accepted and taken on board in survey amendments.
15	Kathryn Rathouse	22/04/2014	Draft ODI questionnaire	Can Accent remind respondents of info they might have forgotten? E.g. on Q27, it might help to remind respondents what the rewards and penalties are, and what they are for. These points were explained on page 4 but I'm not sure respondents will still remember them here. If it seems too repetitive to include the info again here, maybe use something like hover tags for anyone who feels in need of a reminder.	Challenge accepted and taken on board in survey amendments.

16	Kathryn Rathouse	22/04/2014	Draft ODI questionnaire	Can Accent simplify the way any of the questions are asked? E.g. Q27 - using different response options (instead of agree/disagree scale) might slightly lessen the cognitive load. E.g. "Do you think the penalties for xx should be more, less, or the same as for xx?" (rather than "To what extent do you agree that the penalties should be greater for xx than xx?") Q27a - maybe explain the three options before asking the question. E.g. "We are considering three options: xxx, xxx, and xxx. Which would you prefer?	Challenge accepted and taken on board in survey amendments.
17	Roger Darlington	24/04/2014	Draft ODI questionnaire	Overall, my anxiety is about the length and complexity of the questionnaire and the capacity of many respondents to make meaningful judgements. In Annex D of the CCG report to Ofwat, we had already expressed some anxiety along these lines: "... we have felt that there were times when customers were asked in research to comment on issues that they really could not meaningfully comment on e.g. pace of change (in the online panels), effectiveness of water resource options (in the WRMP focus groups), and WTP linked to changes in satisfaction (in the outcomes research)."	Challenge accepted and taken on board in survey amendments, in conjunction with challenges 13-16 above.
18	Roger Darlington	24/04/2014	Draft ODI questionnaire	First, some overall questions: • This is described as an online survey. Does this mean that the respondent will complete it alone and at a time of their choosing? • Is there any incentive to complete the questionnaire? • What is the process for ensuring that Accent receives 400 completed questionnaires by 29 April? • The questionnaire opens with a note of the time the interview starts and ends with a note of the time the interview concludes. Is this information generated automatically or does the respondent have to input it? • What is the intended time to complete the questionnaire? • Will the actual average time be included in the research report?	• Yes the respondent will complete it alone and at a time of their choosing • They will receive some form of points as they are panellists but no cash incentive • Accent liaise with the panel company (however, timings have slightly changed) • This is a note for the programmers - they do not need to input it • Around 10 minutes • We can get an indication but it's not completely accurate as respondents can leave the survey open - then return
19	Roger Darlington	24/04/2014	Draft ODI questionnaire	Introduction: The initials MRS are used twice before they are explained The last sentence should actually be much earlier and provide a hyperlink to the Code of Conduct.	Challenge accepted and taken on board in survey amendments.
20	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 5: What is the reason for asking this question? Can the respondent be advised of the reason?	It determines whether we need to display sewer company related information or not.
21	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 8: Why is this question being asked? Will not the post code determine if the respondent is an SEW customer?	It is asked if they do not appear in the postcode look up.
22	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 9: Would not a more open question be: "Who supplies your sewage service?"	The question is to determine which sewer company related information is presented to the person. It is phrased this way to act as a prompt to assist, so that we don't exclude people who might not immediately call to mind their sewerage provider but who do positively identify with one or other of the two companies that do supply South East Water customers.
23	Roger Darlington	24/04/2014	Draft ODI questionnaire	Main questionnaire: Can a more customer-friendly phrase be used than "in scope"?	Accent use this within many surveys and find it works well, 'in scope' retained in survey.
24	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 12a: After the first sentence, would it not be useful to say something like: "The bills of South East Water customers vary depending on where they live, the size of their home, and whether they are metered. But, to make you aware ..."	Challenge accepted and taken on board in survey amendments.
25	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 14: Why do we have to ask this question? Does SEW not know from the post code whether the property is metered?	There is no read across to SEW systems so no meter check is possible.
26	Roger Darlington	24/04/2014	Draft ODI questionnaire	Current Business Plan: These five paragraphs are critical to the respondent's understanding of the whole questionnaire. Can the text be the subject of some cognitive testing (even if small-scale)? Do the notions of reward and penalty need a bit of explanation?	The slow start process will act as testing for the survey text. The text has tried to balance the need to simplify the concept but providing the key information. The questionnaire has further been simplified in response to Kathryn's comments above.
27	Roger Darlington	24/04/2014	Draft ODI questionnaire	Outcome/Service Measures: Are they outcome or service measures? Both terms are used. Should there be a little explanation of leakage? Could the word interruptions be used before the explanation of the term? The notion of 'demand for water' needs some explanation. The terms 'Below ground asset performance assessment' and 'Above ground asset performance assessment" need expressing in simpler language.	Wording amended to refer to 'outcome' measures consistently. Short explanation of leakage added. This outcome measure now reads: 'Average time water supply lost per property each year through interruptions'. A short explanation of demand for water added. These measures have been amended to 'Above/Below ground equipment performance'.

28	Roger Darlington	24/04/2014	Draft ODI questionnaire	The five scenarios: The scenarios involve a bill reduction of £10, an unchanged bill, a bill increase of £5, a bill increase of £10, and a bill increase of £20. Why have these particular options been chosen, as opposed to a symmetrical set of lower or higher bills or a standard set of increments? Can the selection of these five particular scenarios be justified or explained to Ofwat? Before respondents are presented with the details of the five scenarios, can they be given a summary overview, perhaps in diagrammatic or pictorial form using just two variables (overall scale of change to service levels and level of change in bill)? In relation to customer satisfaction, there are eight measures which over a five year period gives a total of 40 data points. When it comes to the various scenarios, I am unclear whether missing or exceeding a measure applies to any one year or all five years. In Scenario E, for the two asset performance assessments, should "more than twice" be rephrased to "three or more"?	The scenarios have been selected as the most likely scenarios that could be adopted. The final set may or may not be symmetrical. The service levels of deteriorating, stable or improving need to be tested but also exceptional for the full incentive range. They test the range set out in the Ofwat guidance so justifiable and explainable. We moved away from showing all scenarios together as we want them to evaluate each one in their own right, and it was considered to add unnecessary complexity to show them all together. Target performance is annual. Wording amended.
29	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 25: I think that this question needs to be rethought. I would favour something like: "When you considered each of the five scenarios and rated your acceptability of each one, did you feel comfortable that you could do this or did you feel that the exercise was too complicated?"	Challenge accepted and taken on board in survey amendments.
30	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 27: I think that there needs to be another question between the current Q27 and Q27a along the lines: "When you considered each of the five options for reward or penalty and expressed your agreement or disagreement of each one, did you feel comfortable that you could do this or did you feel that the exercise was too complicated?	Question removed.
31	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 33: Why are we asking this question? Is it necessary?	Question removed.
32	Roger Darlington	24/04/2014	Draft ODI questionnaire	Question 34: Again it is necessary to spell out the acronym MRS and provide a hyper link to the Code of Conduct.	Challenge accepted and taken on board in survey amendments.
33	Karen Gibbs	25/04/2014	Draft ODI questionnaire	I would have wanted to see respondents given a clearer option to vote for or against the use of rewards and penalties. All this does is explore views on the application of the concept rather than understand how agreeable it is to your customers. You got a strong steer from customers in your WtP research that they wanted low bills and a steady state in terms of service. There is a danger that there may appear to be a disjoint between these two pieces of research if this later work is done in isolation. As I understand it, Ofwat has said that if a company wishes to make a case for not using rewards as their research shows that customers do not support this approach they will consider it.	Additional question added to test respondents view of whether bills should be linked to performance.
34	Karen Gibbs	25/04/2014	Draft ODI questionnaire	In exploring the concept, I think there needs to be a clearer explanation of how it will actually work. It is not clear when the assessment of your performance will happen and when it will impact on customers' bills.	Frequency of performance assessment added to the survey. Application of incentives to bills tested in survey question, amended following other challenges.
35	Karen Gibbs	25/04/2014	Draft ODI questionnaire	I think you need clear definitions of the levels of service/measure of performance in each scenario – some of it is quite technical and/or industry "jargon".	Survey amended in line with other challenges.
36	Karen Gibbs	25/04/2014	Draft ODI questionnaire	You also need to make clear that these numbers exclude inflation and should try to give some sense of what impact this might have, possibly by giving examples using current figures.	Respondents asked to keep in mind that inflation would be added to the bills shown.
37	CCWater	25/04/2014	Draft ODI questionnaire	Q12a - Presume this means it will average out at £189 but will be more some years and less in others. What about inflation? Hard to Follow	Yes this is the average over 5 years and would be more or less in some years. Additional clarity added.
38	CCWater	25/04/2014	Draft ODI questionnaire	Current business plan: 1. It could sound like they asked all of their customers unless a survey is mentioned.	Wording amended
39	CCWater	25/04/2014	Draft ODI questionnaire	Current business plan: 2. Have suggested deletions here to shorten the text.	Text remains unchanged to maintain sufficient detail being tested.
40	CCWater	25/04/2014	Draft ODI questionnaire	Current business plan: 3. Think it should relate to customer bills here too – its not just about SEW's income but about customer bills which provide that income	Paragraph removed
41	CCWater	25/04/2014	Draft ODI questionnaire	Current business plan: 4. "outcome measure" - Industry jargon. What should this say in order for customers to understand/relate to? Area of service?	Terminology now consistently applied, will test understanding in soft launch.
42	CCWater	25/04/2014	Draft ODI questionnaire	Current business plan: 5."Customer interaction" - What is this? Customer service/contact?	Wording amended

43	CCWater	25/04/2014	Draft ODI questionnaire	Current business plan: 6."Below ground asset performance assessment" - Is there a friendlier way of putting this & the one below? (Above ground asset performance assessment	Wording amended
44	CCWater	25/04/2014	Draft ODI questionnaire	Q15 - "The average water bill with this level of service would be approximately £179 per year , i.e. £10 less than the target plan" - How is this going to be applied when the outcome measures are assessed over 5 years? The wording suggests that the average planned bill of £189 for 2015-2020 will change but targets are assessed in 2020?	Wording amended
45	CCWater	25/04/2014	Draft ODI questionnaire	Q19 - "Customer Satisfaction, scenario C, Annual target performance exceeded in two measures " - Is this any two of the measures in each of the years? Or the same two measures every year?	Any two measures, not necessarily the same.
46	CCWater	25/04/2014	Draft ODI questionnaire	Q27a - "Spread evenly across the 5 years between 2015 and 2020." - But targets are assessed in 2020 so bill changes can't start from 2015.	Wording amended
47	CCWater	25/04/2014	Draft ODI questionnaire	Q27a - "For them to vary year by year in line with their performance, but equalling the change shown by 2020?" - But you won't know if leakage has exceeded it's target each of the 5 years until 2020.	Wording amended
48	Roger Darlington	07/05/2014	Top line results on ODI questionnaire	I believe that earlier research questioned customers on the acceptability and affordability of bills. Could Accent include in the final report a comparison of the previous findings with the current findings?	See final ODI commentary
49	Roger Darlington	07/05/2014	Top line results on ODI questionnaire	54% state that the current bill is too much, but 75% say an increase of £5 would be acceptable and 71% say an increase of £10 would be acceptable given certain improvements in service. How does Accent or SEW reconcile these two sets of findings?	See final ODI commentary
50	Roger Darlington	07/05/2014	Top line results on ODI questionnaire	The original Willingness To Pay research showed little if any appetite for higher bills in return for improved service, but the latest research suggests that even an increase of £20 would be acceptable to a majority in return for specified service improvements. How does Accent or SEW reconcile these two sets of findings?	See final ODI commentary
51	Roger Darlington	13/05/2014	comments on performance commitments commentary	Just to be absolutely clear, as I understand it, SEW has not changed any of the performance commitments or any of the proportionate allocations of these commitments to the retail and wholesale businesses, but it has provided further information to Ofwat on how these decisions were reached and, in the company's view, this further information will satisfy the regulator. Is this correct?	This is correct.
52	Roger Darlington	13/05/2014	comments on performance commitments commentary	On the Abstraction Incentive Mechansim, SEW has now identified with EA relevant data in relation to the 40 applicable sites and selected seven of these sites for inclusion in Table W7. Could the CCG be advised of the significance of inclusion in Table W7 and of the proportion of water abstracted by these seven sites in relation to the total of 40?	Table W7 asks for information in order to set up the AIM reputational incentive. Ofwat will use this information to inform their final decision on the scope of the AIM. We will follow up on the second request re. proportion of water abstracted, I'll confirm with our Water Resources team.
53	Roger Darlington	13/05/2014	comments on performance commitments commentary	As I understand it, leakage is to be reduced by 5.1 Ml/d (from 93.2 Ml/d 88.1 Ml/d) between the five years 2015-2020 and then by a further 2.5 Ml/d in the twenty years 2020-2040. Is this correct? If so, why is the rate of reduction so much lower after 2020?	This is correct and is in line with the Water Resources Management Plan. The leakage reduction in 2015-20 is assisted by the customer metering programme, fixing leaks identified at the time of installation. With the completion of the metering programme expected in 2020, leakage reductions will be lower post 2020.
54	Roger Darlington	13/05/2014	comments on performance commitments commentary	SEW states that the design of the satisfaction tracker surveys, the interpretation of the results, and the final performance position will initially be reviewed and challenged by the CCG and, from April 2015 onwards, the new Customer Panel. Does this mean that the CCG will continue until March 2015?	We expect the CCG to be in effect until the end of the PR14 process which includes post final determination in December 2014.
55	Roger Darlington	13/05/2014	comments on affordability commentary	Given that SEW regarded its acceptability research as robust but is now going to do some further research around the impact of the Thames Tideway Tunnel, can the supporting commentary make clear exactly why this further research is being carried out and how it will be different from the previous research?	Yes. As per my note below, the commentary circulated was drafted prior to the research developments. We will clearly set out in the updated commentary, why we have carried out this extra research, how it differs from the previous piece and what the implications are of the results.
56	Roger Darlington	13/05/2014	comments on affordability commentary	What is the timetable for the conduct of and reporting on this further research and how and when will the CCG be appraised of the outcomes?	We are currently awaiting confirmation of the final text from Thames. Once received Accent will commence with the survey and assuming full launch by the 22nd May, we expect initial results week commencing 16th June. This is incredibly tight for the 27 June but we are confident we'll get there.
57	Roger Darlington	13/05/2014	Early Submission Proposal	As regards Outcome Delivery Incentives, the Early Submission Proposal mentions "possibility of earlier submission subject to customer research findings". What is the likelihood of this and how would it affect the CCG timetable?	As our principles set out, any early information sharing with Ofwat is based on that information being draft and we have indicated that this includes before review and challenge from the CCG. Therefore, this does not have any implications on the CCG timetable.
58	Roger Darlington	27/05/2014	Update note to group	This is very helpful - many thanks. The call from the Ofwat team on 4 June will fit well with the CCG meeting on 10 June. However, I would request that the company does not wait to the CCG meeting to provide feedback from the Ofwat meeting but, in order to allow time for study and reflection, sends us a written note at some point between 4-10 June.	An update note will be circulated to the group by close of play on 6th June.

59	Roger Darlington	27/05/2014	Update note to group	As regards ODIs, the language is of course very familiar to Ofwat but, for the purposes of reporting to the CCG and for any external stakeholder communications, can we have clear and simple definitions of deadbands, caps and collars.	• Deadbands reflect the area of performance where no incentive (reward or penalty) will apply. • Penalty collar reflects the worst level of service where the penalty would be applied. If performance deteriorates further, no additional penalty will apply. • Reward cap reflects the best performance level where the reward would still apply, if performance improves beyond this no further reward would be applied. The above is best shown graphically on sheet 2.
60	Roger Darlington	27/05/2014	Update note to group	I note the new development that the company will share the revised ODIs with Ofwat early. When you know the dates, can we be advised when Ofwat will be sent this information and when it will respond to it.	We plan to send Ofwat the draft commentary and information prior to the 27 June. We will determine the timing following the meeting on the 4 June.
61	Roger Darlington	27/05/2014	Update note to group	As regards the comparison with Affinity Water and South West Water, I think the CCG would find it useful to have a bit more information on how SEW's revised ODIs are "on a par" with those of the two enhanced companies. Also is there now any relevant information on the ODIs of Northumberland Water and Dwr Cymru that might be relevant and helpful.	The proposed ODIs are consistent with those of the enhanced companies in terms of the measures proposed and whether reputational, financial penalty or financial reward incentives are proposed. We have also carried out a comparison of the financial values used and there is consistent in some values for example the value of incentive per ml/d for leakage. Further comparison of measures is shown in the table on Sheet 3. The draft determinations for Northumberland and Dwr Cymru are being analysed and any key points of comparison will be shared with the group at the meeting on the 10 June.
62	Roger Darlington	27/05/2014	Update note to group	On affordability testing, we are advised that Thames Water has now supplied SEW with "revised numbers and text". What is the nature of these revisions? How significant are they?	The revisions are not material, original text and revised text shown on Sheet 4.
63	Roger Darlington	27/05/2014	Update note to group	It is good to note that the company is looking at how it can bring the average bill down following the upward revisions that have had to be made. What are the main options here and what criteria will be used to select particular options?	The financial modelling is still in progress, we will outline the options during the progress update at the meeting on the 10 June.
64	Roger Darlington	27/05/2014	Performance commitments – the final version as sent to Ofwat on the 19th May.	The paper explains clearly how the allocation of commitments to separate controls has been made. It is notable that, in 7 cases out of 13, "management expertise" has been utilised. It might be useful for a bit more information to be given in each case so that the decision does not look too subjective or arbitrary.	We will review this section of the commentary for final submission.
65	Roger Darlington	27/05/2014	Performance commitments – the final version as sent to Ofwat on the 19th May.	I continue to struggle to understand the significance of Table W7 on abstraction sites. You have previously advised me: "The proportion of water abstracted under peak licence conditions by the sites included in table W7 for AIM is 29.3% (45.58Ml) of the initial sites suggested by OFWAT for inclusion into AIM (155.7Ml). To put this in perspective, this amounts to 0.04% of total Company peak licenced abstraction." I am unclear how the 40 sites and the 7 sites respectively were chosen and why this effort is worthwhile in respect of a mere 0.04%.	The sites were selected based on the criteria set out by Ofwat and the EA. Ofwat have confirmed this data and AIM have been removed from the PR14 process and will work on refining the data and how it can be used post PR14.
66	Roger Darlington	27/05/2014	Performance commitments – the final version as sent to Ofwat on the 19th May.	Under the heading "Commitments value for money", the paper mentions "an innovative carbon calculator". Would it be useful to give Ofwat a bit more information about this calculator?	Ofwat feedback requested that we set out our long term commitments so we have focused on this. We will receive feedback from Ofwat shortly and will determine whether further information on the carbon calculator will add value.
67	Roger Darlington	27/05/2014	Performance commitments – the final version as sent to Ofwat on the 19th May.	Under the heading "Long Term Customer Interests", the paper rightly notes that customer expectations are changing. It would be useful if the company could give some indication of how it believes expectations will change.	We will add further commentary in this area.
68	Roger Darlington	27/05/2014	Performance commitments – the final version as sent to Ofwat on the 19th May.	Turning to Table 2, I have previously commented that leakage is to be reduced by 5.1 Ml/d (from 93.2 Ml/d 88.1 Ml/d) between the five years 2015-2020 but then only by a further 2.5 Ml/d in the twenty years 2020-2040. It has been explained to me that the leakage reduction in 2015-20 is assisted by the customer metering programme, fixing leaks identified at the time of installation, and that, with the completion of the metering programme expected in 2020, leakage reductions will be lower post 2020. Would it be useful to explain this?	Agree, we will add commentary to explain this.
69	Roger Darlington	27/05/2014	ODIs – draft commentary for Ofwat.	As regards the summary table, I'm sure that Ofwat fully understands the data but, for CCG members, could you explain the relationship between the figures for maximum per year and maximum for the total AMP. Clearly it is not simply a case of multiplying the first by five.	With the exception of the two asset performance measures, the maximum for the AMP is the annual figure multiplied by 5.
70	Roger Darlington	27/05/2014	ODIs – draft commentary for Ofwat.	It is helpful to have set out so clearly in the commentary the six objectives of the company in designing its ODI regime. I wonder if something needs to be said on the relative size of maximum penalty and maximum reward. On the one hand, I believed that Ofwat wanted some broad equality of the two. On the other hand, I note that, in the case of both Affinity Water and South West, Water, maximum reward is much less than maximum penalty.	Ofwat have not given any guidance on symmetry of penalties and rewards and as you note, the packages shown in the draft determinations published to date are asymmetric. The maximum reward and penalty is the result of the cumulative individual incentives, the overall size is sufficient to drive the right behaviour and whilst the analysis is still be completed, we believe will be in line with the guidance published by Ofwat.
71	Roger Darlington	27/05/2014	ODIs – draft commentary for Ofwat.	Table 3 of the commentary is really useful, but I wonder whether there should be a summary noting how many changes of each type have been proposed. This would enable the company to highlight that in two cases - leakage and average interruption time (both important to customers) - SEW has moved from a reputational incentive to a penalty and reward approach.	Agree, a summary table will be added.

72	David Howarth (EA)	27/05/2014	ODIs – draft commentary for Ofwat.	I'm sure this point has already been made but while we recognise that so many of your ODIs are based on direct customer ratings of your performance (and so a true test of customer satisfaction) some of the scores will be dependent on how the information is put to them. While for example, appearance of their drinking water or whether the pressure is sufficient is linked directly to customer experience some of the ODI are not and will be influenced by the information presented to them before they give a rating. For example: • Customers consider the level of leakage to be acceptable • Customers consider bills to be value for money This will be an important role for your new customer panel.	Agree, this will be a key role for the new Customer Panel. The panel will review and challenge the design of the surveys and interpretation of results.
73	David Howarth (EA)	27/05/2014	ODIs – draft commentary for Ofwat.	We are pleased that you have maintained the principle of no financial incentives on compliance outcomes.	***No Response required***
74	David Howarth (EA)	27/05/2014	ODIs – draft commentary for Ofwat.	Of the ODIs based on metrics (rather than customer satisfaction scores) we consider there are two that have environmental outcomes; leakage and the frequency of water use restrictions. We do not offer comment on the value of caps, collars, deadbands, incentive and penalty rates – you state that the incentive rates are based on WTP data. We would be interested to know whether the incentive rates chosen (which you say are based on WTP and meet Ofwat guidelines in terms of & RoRE) will truly incentivise the company to outperform its WRMP on leakage performance.	The Company can confirm the incentive value is sufficient to outperform the leakage targets set for 2015-20.
75	David Howarth (EA)	27/05/2014	ODIs – draft commentary for Ofwat.	We note you have a performance commitment Meeting demand for water based around your SoSI score. We think this pc would more correctly be entitled: Meeting and managing the demand for water.	One of our principles has been to maintain the outcomes and performance commitments. We recognise an important aspect of meeting out performance on SOSI will be to manage demand and this will be emphasised in the description of the measure.
76	David Howarth (EA)	27/05/2014	ODIs – draft commentary for Ofwat.	Sustainability outcomes – We will reduce our impact on the environment - no detail provided. We would like to have the opportunity to comment on this ODI in future. And while monitoring abstraction at low flows at environmentally sensitive sites will provide useful data it doesn't by itself meet the outcome of We will reduce our impact on the environment. What will SEW do with these data? How will it use these data to reduce its impact on the environment? That is what the ODI should address.	We have committed to continue to work with the EA and Ofwat to establish a robust and meaningful performance commitment on this measure. We will ensure this continues through our CCG as well as our day to day EA contacts.