

2nd October 2014

The Chairman
Sembcorp Bournemouth Water

Dear Chairman

Customer Engagement Planning Forum response to Ofwat's Draft Determination for Sembcorp Bournemouth Water

I write to you effectively for Ofwat in my role as the independent Chairman of the Customer Engagement Planning Forum (CEPF), and on behalf of the Forum which essentially operates as a Board.

Following the publication of Ofwat's Draft Determination for Sembcorp Bournemouth Water's (SBW) price limits on 29th August 2014, a meeting of the CEPF was held on 18th September 2014 to discuss the content and any implications of this on SBW's previously fully endorsed Business Plan. The purpose of this letter is to provide our response to Ofwat's Draft Determination.

The first point to note is that we were pleased that the Draft Determination broadly reflected SBW's Business Plan, although we do have some concerns with Ofwat's draft decisions as detailed below. Our comments are as follows:

Customers' bill profile

Ofwat has reduced the PAYG ratio from 80% to 75% which in turn helps reduce customers' bills even further in 2015-20 while ensuring the company remains able to finance its Business Plan commitments. However, for a company with a small investment programme we question this intervention and the impact this will have on customers' bills in 2020-21. The CEPF supported the company's approach in its Business Plan and considered that it achieved a good outcome for customers. In recent research carried out by SBW in response to Ofwat's Draft Determination, from a representative sample, 69% of household and 66% of non-household customers surveyed said that they prefer a smooth/stable bill profile over the ten year period to 2025. We believe Ofwat should reflect the views of SBW's customers in its Final Determination of the PAYG ratio.

Household retail input price pressure (IPP)

SBW commissioned Economic Insight to carry out further work and analysis on efficiency benchmarking of SBW's retail household business. The CEPF has reviewed this new evidence and supports the findings that SBW is relatively efficient in its retail business,

but that its net IPP claim might be reduced to 1.29% per annum from 2.40% per annum. We therefore feel Ofwat should provide funding for this revised IPP claim adjustment, as the CEPF believes that there is limited scope for SBW as an efficient company to make further savings.

Wholesale cost adjustments

Additional costs for leakage – SBW’s customers have identified reducing leakage as one of their top priorities for the company to address and are willing to pay for improved levels of service in this area. The CEPF supports the principle of setting a stretching target for this performance commitment but looks to Ofwat to reflect customers’ preferences and ensure that the costs for this atypical work is funded in its Final Determination.

Selective metering – The CEPF has been supportive throughout of SBW’s metering strategy and so is disappointed that Ofwat has disallowed the selective metering programme based on the company not having a supply demand deficit. The CEPF acknowledges that SBW felt it needed to focus on the areas where Ofwat’s draft decision has a material impact on its ability to deliver its Business Plan, but we are also disappointed that SBW is willing to accept Ofwat’s view on selective metering. We see it as short-term thinking. SBW has been working hard with its customers to change the culture towards the efficient use of water, of which metering has been an important element. Metering has driven changes in demand particularly by reducing peak demand over recent years and we feel that to reverse the direction of travel is highly likely to be misinterpreted by customers and lead to a perceived reduced importance to save water. We therefore request that Ofwat considers reinstating this programme with appropriate funding in its Final Determination.

National Environment Programme (NEP) – SBW has statutory obligations related to catchment management and invasive species investigations. Ofwat rejected the company’s claim adjustment for these NEP schemes and so SBW commissioned Cascade Consulting to undertake an independent review of the work required and proposed costs. The CEPF believes that this independent review provides robust evidence to support the need and the atypical costs of the schemes proposed, and therefore supports SBW’s view that funding should be allowed in the Final Determination.

Company-specific uplift

Ofwat has awarded SBW an uplift to its cost of debt but has required SBW to engage with its customers on whether they are content for this uplift to be included in their bills, taking account of the benefits to them and customers more widely as part of its representation to the Draft Determination. The headline findings of this further customer research show that 50% of household customers and 70% of non-household customers surveyed support the inclusion of the uplift for the cost of debt in bills. The CEPF expects Ofwat to recognise SBW’s customers’ views in its Final Determination.

Outcomes and performance commitments

The CEPF noted that Ofwat has amended a number of SBW's performance commitments and financial incentives in the Draft Determination and challenged the company on its ability to meet these. The CEPF is satisfied from SBW's response that the changes made to the Outcome Delivery Incentives will not compromise the company's delivery of the committed service levels.

Non-household default tariffs – The CEPF is broadly supportive of SBW's proposed structure for default tariffs but noted that there is a small but significant number of non-household customers who would see whole bill increases between 5% and 6.2% before the application of the price reduction in 2015-16. These customers will therefore see a significantly smaller overall reduction in their bills, as the remodelling of the tariffs eliminates most of the other cost reduction benefits. It is particularly concerning that a significant number of those affected are small business, which given their size, should expect to be treated comparably with household customers in terms of the overall size of their bill. The CEPF is pleased that SBW will continue to analyse the structure of its tariffs to minimise the incidence effects on non-household customers. Given the major changes taking place in the structure of non-household tariffs, the CEPF supports a 2 year price control to 31 March 2017 with a review in late 2016 to ensure cost reflectivity of the various default tariffs to be implemented from 1 April 2017.

Gainsharing mechanism – SBW provided the CEPF with more detailed information of how this mechanism would work following Ofwat's rejection of its initial proposals. The CEPF is satisfied that SBW is not a pain sharing proposal and that customers can only gain from the mechanism and therefore supports SBW's revised gainsharing mechanism. The CEPF welcomes SBW's commitment to transparently sharing service and financial performance information with an independent customer group, thereby ensuring that any outperformance will be discussed and challenged openly.

Conclusion

Overall, the CEPF believes that the Draft Determination for SBW broadly reflects its customers' priorities but we ask Ofwat to give due consideration to the concerns outlined above ahead of its Final Determination in December 2014.

Yours sincerely



Charles Howeson

Chairman
Customer Engagement Planning Forum