

PORTSMOUTH WATER Ltd
CUSTOMER CHALLENGE GROUP (CCG)
MEETING HELD ON THURSDAY 15 AUGUST 2013

PRESENT: Charles Burns (FSB), Daire Casey (West Sussex County Council), John Colley (Portsmouth Water) In Part, Amy Denford (Secretary), Keith Evans (Fareham Borough Council), Karen Gibbs (Consumer Council for Water), David Guest (Independent Chairman), Marge Harvey (East Hampshire District Council), John Havenhand (Consumer Council for Water), Douglas Hunt (Atkins Independent Reporter), Mike Kirk (Portsmouth Water) In Part, Douglas Kite (Natural England), Terry Lazenby (Portsmouth Water), Simon Oakley (Chichester District Council), Milo Purcell (Drinking Water Inspectorate), Nick Sheeran (Portsmouth Water), Gareth Simmonds (Portsmouth Water) and Neville Smith (Portsmouth Water)

Action

Apologies

Apologies were received from Traci Baker (Hampshire Chambers of Commerce), Jim Barker (Environment Agency), Andrew Day (Ofwat), Cllr Paul Dendle (Arun District Council), Hugh Caley (Carillion), David Collins (Havant Borough Council), Richard Harris (West Sussex Hospitals Trust), Cllr Derek Kimber (Gosport Borough Council), Chris Manning (South Downs) Cllr Kirk Phillips (Winchester City Council), Rod Porteous (Portsmouth Water), Ian Rawson (KWS (Defence), Tim Richings (South Downs), Jon Stuart (Havant & District Citizens Advice Bureau) and Cllr Rod Wood (Portsmouth City Council)

Minutes & Actions of Meeting Held on 25 June 2013

The minutes were taken as a correct record and approved by the CCG.

The following actions were reported on:

Customer Quantitative Research

Nick Sheeran advised that he still had to send Doug Hunt MVA Consultants explanation of why they include one obviously more favourable option in the Customer Research to break down the correlation in the results.

Base Opex

Doug Hunt advised that his actions arising out of this item from the last meeting were going to be covered in this agenda.

Mains Renewals

Doug Hunt advised that his actions arising out of this item from the last meeting were going to be covered in this agenda.

Outcomes

Neville Smith advised that a Sub Group had been formed to look at the Outcomes in more detail and they met on 1 August 2013. Feedback from this meeting will be provided later in this agenda.

Company's External Assurance Process / Timetable

Karen Gibbs advised that she still had to provide the Company with the name of a recommended Customer Research Expert to provide a Report giving further assurance.

Karen Gibbs advised that she will inform the CCG of the CCWater Acceptability Threshold Research that had been completed later in this agenda.

NJS

KG

Nick Sheeran advised that he still had to reconvene the Customer Research Sub Group to challenge the deliberative research. MVA have started preparing the Research and the Sub-Group will be reconvened shortly.

Approach to CCG Assurance and CCG Report

Neville Smith advised that a paper on the Company's Past Performance was enclosed with the agenda for the CCG's information.

Base Opex and Cost of Capital

Doug Hunt advised that his actions arising out of this item from the last meeting were going to be covered in this agenda.

Nick Sheeran advised that his actions arising out of this item from the last meeting were going to be covered in this agenda.

Nick Sheeran confirmed that Ofwat were not going to provide any information on the Cost of Competition. They referred the Company to the High Level Group.

Timetable and CCG Meeting Dates

Amy Denford confirmed that meeting dates had been scheduled up until the submission of the Business Plan and the dates were enclosed with the agenda.

Water Quality Schemes - Boreholes Turbidity

Neville Smith informed the CCG that this Scheme would no longer be included in the Business Plan as the risk will be dealt with in different way.

Milo Purcell advised that the DWI can write a letter of recommendation for these Schemes if Company wanted to include them in their Business Plan.

1. Consumer Council for Water Research – Acceptability Threshold

Karen Gibbs circulated a presentation on the Customer Acceptability Threshold Research recently carried out by CCWater. She advised the CCG that CCWater have placed a great deal of importance on the Company carrying out acceptability testing on their Business Plan to sense whether the Company correctly interpreted the results of the Customer Research.

The Research was conducted via Focus Groups across the country. The Research showed on average 70-80% of Customers found Company's Business Plans acceptable with a range of 64-95%. Research also gave an indication of how customers felt engaged in the process.

Nick Sheeran questioned that as the Research had been based on Focus Groups it is not statistically robust and therefore can it be relied upon? Karen Gibbs confirmed that it was not statistically significant it was to inform Company's and give an indication of what Customers would find acceptable.

Douglas Kite questioned how the Company chooses between something with high public acceptability or high cost effectiveness e.g. leakage v metering.

Karen Gibbs advised that whatever choice is made, the reasons why need to be explained to Customers.

Terry Lazenby commented that Douglas Kite made a good point and that choices shouldn't be looked at individually but put in a package.

Gareth Simmonds advised that the Company's Acceptability Testing will look at Options, Packages and Priorities.

Marge Harvey asked if demographics were used in Customer Research. As different Options Packages would appeal to different demographics.

Nick Sheeran confirmed that the samples were representative of demographics.

Neville Smith confirmed that the point raised by Douglas Kite in respect of high public acceptability v high cost effectiveness e.g. leakage v metering would be addressed at the next meeting with a cost benefit analysis on metering being presented for Doug Hunt to review.

Neville Smith questioned what would happen if a Company does not achieve 70% acceptability would that be a problem? Karen Gibbs confirmed that this was not a Regulatory benchmark the Research was carried out just for information to help companies strive to achieve a Customer acceptability level of 70-80%. Whatever level companies achieve the testing will tease out why, which would then be for each Company to address.

Doug Hunt questioned if a national benchmark comes out of this Research, is someone going to look at who is marketing this Acceptability Testing. Karen Gibb's confirmed that there were high level principles set for Acceptability Testing that have been published to assist and Companies are using Consultants that are well experienced in this area for national consistency.

2. Summary of Responses to WRMP Consultation

Gareth Simmonds updated the CCG confirming that consultation has led to the receipt of 15 representations mainly from Stakeholders and Regulators, not any direct Customers.

The representations received commented on the following areas;

- Stakeholder Engagement
- Demand Forecast
- Optional Meters
- Bulk Supplies
- Leakage

John Havenhand commented that there was no financial incentive for Customers to reduce their consumption as water bills are so low. However, there would be a saving for them on their sewerage bills if they had a meter installed and this message needs to be communicated effectively to Customers.

Gareth Simmonds confirmed that the Company works proactively with Local Authorities to align the WRMP with Local Authority Plans.

3. Outcomes and Measures of Success

Neville Smith advised that the appointed Sub-Group met on 1 August 2013 to discuss in more detail the Company's Outcomes. Revised Outcomes were enclosed with the agenda for the CCG's comments. Neville Smith explained that the next step would be to agree incentive rewards for success, and penalties for failure against each Outcome. He confirmed that a draft proposal would be brought to the next meeting for comment.

Neville Smith advised that the Outcomes would continue to be refined and wording refined throughout the process, and highlighted several suggested amendments since issuing the agenda.

Douglas Kite advised that there needed to be a connection between the Customer priorities established through Customer Research and the Outcomes. He noted that Carbon was not included in the Outcomes. Neville Smith agreed to look at this.

Douglas Kite advised that some of the Outcomes would be difficult to measure e.g. biodiversity. Gareth Simmonds confirmed that measurement methods are being considered.

Neville Smith confirmed that other than biodiversity, the Company chose Outcomes that were measurable and had statistics for them.

David Guest questioned how the Company could measure the Outcome 'value for money'. Neville Smith advised that Customer Satisfaction Surveys; although not statistically robust, gave the Company a good steer.

Simon Oakley reiterated his concern from an earlier meeting regarding highway impact from leakage and how was it measured. Neville Smith confirmed that interruptions to supply statistics are available, measured by the number of properties affected over 3 and 6 hour periods.

Gareth Simmonds added that when the Company sets leakage targets it takes into account traffic disruption and a cost appraisal for that is included.

Milo Purcell advised that other Companies have employed specialist risk assessments for impact on business, especially financial, when setting incentives. Neville Smith confirmed that the Company will carry this out internally as one of the Company's sensitivities.

Gareth Simmonds advised that the incentives would also include Ofwat's Service Incentive Mechanisms (SIM's).

4. Cost of Capital – Current Assumptions

The Company presented its current view on the weighted cost of capital. The potential impact of Havant Thicket on gearing was raised, as this would require significant capital. The CCG challenged whether this risk should be paid for by Portsmouth customers if the scheme is primarily intended to supply Southern Water.

It was also requested that the potential impact of the Ofwat gearing assumption on bills should be provided at the next CCG.

Mike Kirk joined the meeting

5. Base Operating Cost – Final Position

Nick Sheeran circulated a paper on the Company's proposed Base Operating Costs to be included in the Plan and on Competition Costs.

A discussion followed which covered electricity, pensions, competition and reduction of leakage.

Key challenges were made in relation to electricity, where Nick Sheeran noted that the central assumptions used by Ofwat in the methodology paper were used, the pension assumptions were based on an initial valuation of the pension scheme, and competition costs, were based on Industry estimates.

John Colley joined the meeting

6. Legacy Items

Nick Sheeran informed the CCG that at the end of the planning period Ofwat complete a review of the initial assumptions used and make any necessary adjustments for the next planning period: these are referred to as legacy items. He advised that Ofwat have issued guidance on how to calculate these and therefore

the Company has confidence that they will find this acceptable.

Neville Smith highlighted that legacy items impact on bills by an increase of 4%.

Nick Sheeran advised that they take into account the Cost of Capital, Base Operating Costs as well as legacy Items to get the overall implications on bills which will be addressed later on the agenda.

Simon Oakley requested a breakdown on the revenue correction mechanism. It was agreed that this would be provided at the next meeting.

Nick Sheeran added that commercial consumption had unexpectedly decreased which had an affect.

7. Capital Expenditure

In the absence of Rod Porteous, Neville Smith updated the CCG on deteriorating water quality and mains renewals. He welcomed John Colley, Investment Manager to field any technical questions.

Water Quality

Neville Smith advised that a scheme was required to reduce the risk of Cryptosporidium at two sites. He confirmed that a proposal would be submitted to DWI for the installation of UV Plants at both sites.

Douglas Kite questioned whether the problem could be tackled at source as a cheaper option.

Milo Purcell agreed, and advised that the DWI would recommend Catchment Management which would have to be part of the solution to help the end of pipe solution. However, he confirmed that it would depend on whether that would deliver a quick enough solution to the Cryptosporidium threat and if not, then it would look at interim solutions e.g. UV Plants.

Terry Lazenby raised concern that the Company would not want to risk water contamination. He advised that levels of incidents were increasing and there was a conclusive Geological Survey Report on the matter. He stressed the need for these schemes to be implemented.

Milo Purcell suggested the Company expand on the information they have received at the next CCG.

Terry Lazenby highlighted that relying solely on Catchment Management as a solution leaves the Company and therefore the Customer at risk.

Simon Oakley asked what has changed since the last risk assessments.

John Colley confirmed that the Company had addressed Catchment Management to discover why it has happened, but this is not yet identifiable. He explained that the Company was taking a multi-barrier approach; not just plant, but will also minimise risk through Catchment Management. He emphasized the need for the Company to protect public health.

Simon Oakley stressed the need to identify the source of the problem. John Colley confirmed that there are continuous risk assessments being carried out to identify problem and a better quality well-lining had been installed. The query was made as to whether the 'new' risk was being caused by raw water deterioration and, if so, were alternative options available for mitigation. Milo Purcell indicated that the main reason for the re-appraisal was due to the detection of crypto in samples, and that this may have been associated with recent weather patterns. In terms of alternative options for control, both the DWI and the Reporter team will be challenging to determine if this is feasible, but at this time a catchment

management may be too late.

Mains Renewals

Neville Smith advised that the Board had decided to restrict distribution mains renewals to 22km, which would allow burst levels to remain at current levels and not increase prices for Customers.

John Colley advised that trunk mains were being reviewed by a physical condition assessment. Excavating in areas with high corrosive ground, testing for corrosion and estimating likelihood of future failure.

Doug Hunt confirmed that mains renewals had been challenged thoroughly and advised that the risk involved was reasonable.

Milo Purcell queried whether trunk mains had been subject to sufficient analysis. John Colley noted that historically they had not been a problem and so minimal expenditure was proposed, but this had not been checked by Doug Hunt for assurance purposes.

Marge Harvey left the meeting

Milo Purcell suggested that the Company make a statement in their Plan re the resilience in distribution mains and likelihood of bursts. The Company has an interconnecting network and burst-impact on Customers is low. He also commented that high cost work can it be spread over 2 AMP periods to reduce impact on customer's bills.

Doug Hunt confirmed that his report dealt with balancing current and future bills.

8. CCG Confidential Discussion

The Portsmouth Water Representatives left the Room for the CCG Members to have confidential discussions. This part of the Meeting was minuted separately.

9. Feedback to Company following Customer Challenge Group Confidential discussion

David Guest requested the Company allow a one hour time slot on the agenda at future meetings for deliberation and decisions.

AD

Doug Hunt fed back to the Company some issues raised at the confidential discussion as follows;

Concern over Company's reputation in respect of promoting water efficiency.

Company had not included water quality failures in mains renewals evaluation. Gareth Simmonds confirmed this was addressed through DOM's Strategy and will discuss this strategy with the CCG at a later date.

RCP

For opex, the CCG challenged and wished to see greater visibility of the potential for efficiency in staff/manpower costs.

The CCG questioned how financial risks are managed. The CCG were not challenging the technical details – e.g. Cost of Capital analysis, but the process, was it balanced, has what is in the best interest for the Customer been considered?

Water quality risks were discussed, and Milo Purcell indicated that he will cover them at the next meeting.

MP

David Guest advised that the CCG will start to engage in the reporting process and will give continuous feedback to the Company.

10. Outstanding Issues for Review

Neville Smith advised that the following issues were outstanding for review;

- Incentives
- Catchment Management
- Costing for Capital Schemes
- Capital Maintenance – Non-infrastructure

He confirmed that the above would be discussed at the next meeting, where they relate to bills and what the Company are proposing for efficiencies.

NS

Milo Purcell asked for one additional item to be included on the next meeting agenda, to draw comparisons between Strategic Direction Statement and the Business Plan. How Company will deliver objectives. CCG can see Company is not just looking at 5 years but long term. Focus on expenditure profile through AMP Period and traditional dip at the end. Ofwat have provided in methodology that expenditure in AMP6 can be brought forward to AMP5. Could this be done?

NJS

Nick Sheeran confirmed that due to impact on gearing he did not think it would be a good idea to bring capital expenditure into this period.

Milo Purcell also requested that the Company demonstrates how ownership of the Business Plan has changed.

11. Implications for Prices

Nick Sheeran presented to the CCG on the current view of the assumptions being included in the Business Plan having implications for prices. He circulated a paper showing the real changes excluding inflation. He confirmed that the Board's aspiration would be to have no increase before inflation.

Following challenge by Milo Purcell, he confirmed that the Company does not yet know what impact the assumptions will have on business financeability as that part of the Model is not yet available; however, this will be presented at the next meeting.

NJS

Terry Lazenby advised that this needs to be presented with Customer preferences and the Company's Outcomes for CCG to challenge.

NJS

12. Update on Next Stage of Customer Research

Nick Sheeran advised that the Company had completed its Customer Research and have decided to carry out Deliberative Research in two areas; Leakage and Resilience. This will consist of Customers in small Focus Groups, to understand Customers views on leakage and resilience.

13. Update on External Technical Assurance Reviews

Doug Hunt gave the CCG assurance that his Technical Review on Distribution Mains Renewal is now complete and that he will now review Trunk Mains. He confirmed that the methodology approach was put together well. There were uncertainties on leakage risks and future spend profile, but the Company have amended their proposals to allow for this and hence proposals are now in line with the Assurance Review. He confirmed that what the Company have included in Business Plan is therefore reasonable for infrastructure maintenance. In respect of above ground maintenance it is too early to tell. Further refining/challenge being done to programme. Approach is reasonable and as you would expect.

Quality Schemes Review will be looked at in more detail. He advised that the decision whether each scheme is needed is down to DWI, therefore the CCG will

just challenge the proposed solution.

In respect of Operational Costs there is not much to assure on. He confirmed that he is awaiting the Actuarial Valuation Results to review. Electricity is taken out of the Company's hands as Ofwat are benchmarking. He will provide a further update at the next meeting.

DH

14. August Data Submission and Report from External Assurance

Doug Hunt circulated his Report on the August Data Submission. He confirmed this was a standard submission with no significant matters that CCG need to challenge. He gave the CCG assurance that the submission was accurate, reliable and complete.

Milo Purcell asked if there is anything the CCG need to know about regarding efficiencies. Neville Smith advised that efficiencies have been made relative to the Final Determination in 2009 and the Board need to decide if they are passing those benefits to Customers.

Milo Purcell asked if Company are demonstrating innovation in Business Plan. Doug Hunt advised that the process is moving more in line with business best practice.

15. Calendar of Meetings

Tuesday 24 September 2013
Tuesday 22 October 2013
Tuesday 12 November 2013

16. Any Other Business

There was no other business.