

**PORTSMOUTH WATER Ltd
CUSTOMER CHALLENGE GROUP (CCG)
MEETING HELD ON TUESDAY 22 OCTOBER 2013**

PRESENT: Paul Barfoot (Portsmouth Water), Hugh Caley (Carillion), Amy Denford (Secretary), Karen Gibbs (Consumer Council for Water), David Guest (Independent Chairman), Richard Harris (West Sussex Hospitals Trust), John Havenhand (Consumer Council for Water), David Howarth (Environment Agency), Douglas Hunt (Atkins Independent Reporter), Derek Kimber (Gosport Borough Council), Douglas Kite (Natural England), Mike Kirk (Portsmouth Water) In Part, Terry Lazenby (Portsmouth Water) In Part, Kirk Phillips (Winchester City Council), Rod Porteous (Portsmouth Water), Milo Purcell (Drinking Water Inspectorate), Nick Sheeran (Portsmouth Water), Gareth Simmonds (Portsmouth Water) and Neville Smith (Portsmouth Water)

IN ATTENDANCE: Paul Le Masurier MVA Consultants

Action

1. **Apologies:** Traci Baker (Hampshire Chambers of Commerce), Jim Barker (Environment Agency), Charles Burns (FSB), Daire Casey (West Sussex County Council), David Collins (Havant Borough Council), Cllr Paul Dendle (Arun District Council), Keith Evans (Fareham Borough Council), Marge Harvey (East Hampshire District Council), Chris Manning (South Downs), Simon Oakley (Chichester District Council) Ian Rawson (KWS -Defence) Tim Richings, Jon Stuart (Havant & District Citizens Advice Bureau) and Rob Wood (Portsmouth City Council)

2. **Minutes & Actions of Meeting Held on 24 September 2013**

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

The following actions were reported on:

Implications for Prices

Nick Sheeran confirmed that following Terry Lazenby's suggestion he would provide the CCG with the Implications for Prices with Customer Preferences and the Company's Outcomes to the CCG later in the meeting for them to challenge.

Update on Customer Research

Nick Sheeran confirmed that he had emailed the research proposal and materials to the Sub Group and confirmed that they would be meeting on 8 November 2013.

He also confirmed that Accent had been commissioned to complete the Peer Review on behalf of the CCG.

Feedback from CCG

David Guest confirmed that the draft CCG Report had been circulated for comments.

Water Quality Risks

Milo Pucrell advised that the DWI had completed their assessment and have written to the Company with their decision on their Submissions. He confirmed that this would be covered later in the meeting for the CCG to challenge.

Neville Smith confirmed that the Company would justify the Capex figure proposed for the Business Plan later in the meeting.

Update on Assurance

Doug Hunt advised that he was in a position to provide the CCG with a full update on his Assurance to date and will circulate a paper later in the meeting.

3. Update on Assurance

Doug Hunt circulated a Technical Note providing a summary of the current findings of the assurance process that Atkins has undertaken. It included both the original assurance items that were discussed with the Company at the start of the process and additional items requested by the CCG.

The CCG discussed aspects of the assurance received to date with the Company before they left the meeting.

Portsmouth Water Representatives left the meeting

4. CCG Discussions on the Draft Business Plan and CCG Report

There was a consensus from the CCG to share the minutes of their discussions with the Company.

Doug Hunt circulated the latest draft of the CCG Report. He advised that he had received further comments from David Howarth.

Doug Hunt advised that the report had been structured according to four key components;

- Role of the CCG and Scope of this Report
- Customer Consultation
- Outcomes and Long Term Strategy
- Business Plan Costs, Risks and Rewards

He asked if the CCG were comfortable with the scope of what the report was trying to achieve;

The remit to comment upon the customer engagement process and the associated outcomes is therefore clear and is addressed accordingly within this report. The remit to provide comment on how well customer's views and priorities have been reflected within the Business Plan is less straightforward, and has been interpreted by the CCG according to the following criteria:

- The appropriateness of the Company's interpretation of customer priorities based on the engagement process and associated survey results.
- The clarity of the link between the customer priorities and the outcomes and ODIs that have been produced, and the degree of commitment offered by the incentives in terms of both measurability and, where appropriate, links to customers' willingness to pay.
- The extent to which the expenditure proposals and balance of risks presented within the Company's Business Plan reflect customer views and priorities.

Milo Purcell suggested including reference to the Acceptability Testing that will have been completed.

Karen Gibbs joined the meeting

Karen Gibbs commented that the Introduction read as if Ofwat had established the Group rather than Company. Doug Hunt agreed and will reword.

Doug Hunt suggested that In reviewing the adequacy of the customer engagement process, the CCG sought to address the following questions:

1. Is the nature and scope of the customer consultation appropriate to a company of Portsmouth Water's size and current favourable position in terms of bills, cost efficiency and the size of the statutory challenges that it is facing?
2. Have the engagement activities been carried out appropriately with adequate methods and sample sizes?
3. Is the interpretation of the process findings, as presented within the Business Plan, appropriate and reflective of customer wishes?

He asked if these were the questions the CCG were hoping to see.

Karen Gibbs commented that they should link customer research to the CCG report.

David Howarth suggested there being a 'golden thread' from Customer Preferences through to Company's Outcomes.

Karen Gibbs advised that there had been a lot of challenge in the Customer Research Sub Group which should be referred to as evidence.

Milo Purcell suggested including bullet points of the Company's initial customer priorities, summarising the work completed to date and then listing the final Outcomes explaining why some priorities were being included and some not. He further commended the Company for providing a lot of information very quickly.

Doug Hunt agreed that section 2 of the CCG report does need to include the early stages and clearly demonstrate how the Company reached the decisions they have made to date.

John Havenhand suggested rewording the paragraph 'The CCG provided challenge and input to each stage of the engagement process, as described below. Whilst the CCG was also presented with the proposed engagement strategy at an early stage, we note that there was less opportunity to challenge the strategy as a whole, as it was presented as a proposal rather than as options for consideration. This occurred largely as a result of the untried nature of the PR14 price review process rather than any failing on Portsmouth Water's part, but this point has been taken into consideration when presenting our final opinion on the adequacy of the customer engagement.' He feels that the wording suggests the challenge was inadequate which is not the case.

Doug Hunt commented that he felt the minutes of the Customer Research Sub Group suggested that there was not much challenge in the early stages but grew through the process, however, he agreed to rephrase.

Doug Hunt asked if the CCG was happy with how the Qualitative Research informed the Quantitative.

Karen Gibbs confirmed that she was comfortable as the Sub Group had the opportunity to meet MVA Consultants to review and challenge all the research proposals and materials.

Milo Purcell commented that he had early concerns as the process seemed to have a slow start, however, as the CCG and Company has grown in trust and confidence the engagement has developed. He also suggested changing the wording 'reasonable minimum' to 'proportionate' in the following paragraph within the CCG report 'In terms of the overall process, the CCG considers that Portsmouth Water has derived and implemented an adequate strategy, although

the approach taken represents a reasonable minimum given the expectations of the PR14 price review process’.

John Havenhand commented that the Qualitative Research should have had more involvement from the CCG Sub Group.

Milo Purcell suggested that this was as a result of Ofwat reducing the timescale.

David Guest commented that had the CCG not lost that month then they would have had more time to challenge to inform Qualitative Research.

David Howarth commented that the report needs to refer to the size of the Company.

Milo Purcell commented that the Company needs to demonstrate that it has reached the widest range of Customers. Confirmation that all demographic has been reached.

Doug Hunt advised that should be assured in the Peer Review. He noted that Nick Sheeran had circulated the Scope of the Peer Review to the CCG Sub Group for comments. Amy Denford circulated a hard copy of the Scope of the Peer Review for further consideration.

Karen Gibbs requested the Chair ask the Company for a copy of the Qualitative Research Final Report.

John Havenhand advised that from memory he thought Customers were asked if they would accept a reduction in service for a reduced bill and they said yes.

Doug Hunt commented that the CCG would need sight of the Final Report to determine. He also noted that the CCG had previously expressed concern over using WtP Surveys to rank preferences.

John Havenhand confirmed that was correct but need to refresh memory on how the process was carried out, e.g. when they introduced money into the ranking of preferences. Need to establish that first and then query.

Milo Purcell suggested the report say that the CCG had diverse opinions on WtP but as a whole had confidence that the Company used best practice, implemented it well and drew reasonable conclusions.

Doug Hunt advised the CCG that they need to address what has the Company has done to address affordability in the plan. He also reminded the CCG that at the beginning of process the Company was talking of positive bill increases but through research have been influenced by economic pressures and messages from Ofwat.

David Guest questioned where a bill increased by RPI comes from, is RPI for increase in staff costs?

John Havenhand commented that other factors impacting on the business will be increasing in cost e.g. energy costs, electricity will go up by more than RPI.

Milo Purcell advised that the Company cannot solely make decisions on customer's views; they have a responsibility to take a long term view, stewardship of their assets.

Derek Kimber advised that other Water Company's were looking at the future, driving metering and reducing leakage to reduce energy costs. Have the Customers been asked to think about the future. If electricity prices double the Company will only be able to absorb so much and will have to pass some on to Customers in the future.

Doug Hunt advised that the Company's energy costs are less than other Water Company's due to natural filtration and reduced treatment.

Doug Hunt feels comfortable that there has been sufficient challenge made on the Company's Outcomes. However, the CCG have not yet been presented with the final ODI's and will need to request these.

Doug Hunt confirmed that he would feedback to the Company those questions and with those answers as well as the comments made during the discussion would revise the CCG Report ahead of the next meeting.

DH

5. Feedback and Questions to Company following CCG Discussion

Following the CCG's Company exclusive discussion Doug Hunt posed the following questions to the Company on behalf of the CCG;

How does the Acceptability Testing fit in with the timing of the CCG Report?

Nick Sheeran advised that the Acceptability Testing is due for completion by the end of October and Results circulated to the Sub Group ahead of their meeting on 8 November 2013. These will then be discussed at the next full CCG Meeting on 12 November 2013. The Peer Review will also adhere to the same timetable.

Is the Company's decision that Customers do not want a reduction in service/bill's one that can be evidenced?

Nick Sheeran confirmed that the most recent research had covered this issue and would be reported on in MVA's forthcoming report.

Paul Barfoot advised that this question was specifically being asked as part of current further research that is being undertaken.

John Havenhand commented that he thought it was asked in the initial stages of the Research and Customers said they would be willing to accept a reduction in service and in turn their bill. Nick Sheeran confirmed that it was asked specifically in relation to the call centre not the business as a whole.

How did the Company decided that Customers Preference of Affordability is a bill increased within RPI? Why is that a fair interpretation of affordability?

Paul Barfoot confirmed that this was also being covered in the current further research.

Neville Smith advised that the Portsmouth Water bill was less than 0.5% of average household income. Added to that the level of deprivation in the Company's area is lower than the national average, therefore this bill shouldn't cause the Customer's affordability issues. However, this is being tested in current further research.

In respect of Leakage does the Company intend to have an incentive to award/penalise, linked to WtP?

Gareth Simmonds advised that the current further research is determining an up/downside for each Outcome. This will enable the Company to calibrate its Outcomes. The current further research is testing that the Company's Incentives reflect Customer's values and this will be presented on 8 November 2013 at the Sub Group Meeting.

David Howarth commented that there was a penalty for Per Capita Consumption (PCC).

Gareth Simmonds advised that the difficulty was in measuring it. Neville Smith added that there was so much variability it would be fairer to penalise.

Milo Purcell suggested approaching Incentives in a different way e.g. what percentage of turnover is at risk.

Gareth Simmonds confirmed that essentially that is what the Company's Outcomes/Incentives were.

Neville Smith confirmed that the Company will produce a variation – up/downside.

NS

When are the Company's Final ODI's & KPI's going to be presented to the CCG and be aligned with the Business Plan?

Gareth Simmonds confirmed that the ODI's had to follow the current further research and the KPI's would be available at the next CCG. The strength of the ODI's will also go to next meeting but the Company does not propose them to change.

GS

When will the narrative to accompany the Business Plan be given to CCG?

Gareth Simmonds confirmed that the key parts of the narrative can be extracted and provided to the CCG at the next meeting.

GS

Neville Smith advised that the Draft High Level Business Plan was almost complete and the Company would make available to the CCG as soon as possible.

NS

The CCG would like clarification on the Financeability Outcome and would like to understand the assumptions made. Neville Smith suggested providing CCG with a paper on assumptions & efficiencies and what the Company thinks the ratios will be and circulate as soon as possible.

NS

David Guest acknowledged that the Financeability of the Company was not within the CCG's remit; however, should there be a Determination not in line with Business Plan the CCG want to know what the impact on Customers might be at high level.

6. Red Flags for Business Plan/Ten Key Messages for Business Plan

Nick Sheeran detailed a number of issues which may attract a 'Red Flag' from Ofwat when they review the Company's Business Plan, and therefore impact whether the Plan is classed as 'Enhanced', 'Standard' or 'Resubmit', along with other key decisions to be made. He explained the reasons why the following items may attract 'Red Flags'

- Increased level of Capital Expenditure
- Inclusion of Farlington washwater recovery
- Leakage
- Non renegotiation of bank loan
- Cost of capital
- Retail uplift on prices
- SIM score – recent performance

Nick Sheeran circulated a paper highlighting the ten key messages which the Company will want to put across in their Business Plan. It should be noted that these are the initial drafts and may be subject to change.

The proposed "Ten Key Messages" are as follows:

- We will improve services but our prices will not increase by any more than inflation. We will achieve this through further improvements in efficiency

and innovation. This follows below inflation price increases every year from 2010.

- As a proportion of household income Portsmouth Water customers pay less for their water than they did 15 years ago. We are the cheapest supplier, by some margin, and one of the most efficient in the industry and we intend to maintain this.
- Customer engagement – we have listened to our customers and our stakeholders and have created our Plan to reflect their priorities and challenges. Engagement has been more detailed than ever before.
- The Board has shown it is committed to keeping bills down by giving up the benefit of rolling over the Opex efficiency achieved from 2010. This amounts to over £2m which we could have charged to customers in the first three years of AMP 6.
- Board Assurance – The Board, including the non-execs, has been involved in every aspect of the development of the Plan and has challenged the content of the plan, in detail, at every stage. The Board fully supports the proposed Plan.
- After very careful consideration the Board believes it is in the long term interest of customers to increase capital expenditure from that allowed at the last determination. This is partly due to new obligations and replacement of short term assets constructed in AMPs 3 & 4, but also reflects the cyclical nature of our maintenance.
- Leakage – recovery plan in place. Being paid for by shareholders, not customers.
- We are different from most other companies in the sector due to our ownership structure (EBT). This allows us to take the long term view.
- Portsmouth Water customers have benefitted from our reliable and resilient assets. We have not had a hosepipe ban since 1976.
- SIM performance – our performance in the Qualitative SIM score has consistently been in the top quartile. We have the lowest level of written complaints in the industry.

Douglas Kite questioned why environment was not amongst the ten key messages. Nick Sheeran agreed that it needed to be included.

NJS

7. Capex Update

Rod Porteous informed the CCG that Capital Expenditure may be a 'red flag' to Ofwat as proposing a large increase from £47m to £63m over the AMP period.

He advised that if the cost of new obligations and requirements were removed from Capex the increase would not then be material.

He confirmed that the Company had employed an Independent Cost Consultant and that the proposals had been subject to robust Board challenges.

He advised that the Consultant had identified Crypto and Farlington Schemes had excluded £3m worth of costs so Capex needed to be reviewed. Schemes submitted for DWI for following reasons;

- Deteriorating Water Quality

- Capital Maintenance Spend to Maintain Water Quality & Serviceability
- Capital Maintenance Nitrates/Oil Pollution

8. **DWI View on Company's Water Quality Risks**

Milo Purcell advised the CCG that the DWI had now written to the Company with decisions on their Submissions.

The Company put forward six submissions;

Lead Submission Supported

DOMs Strategy Commended

Resilience Commended – Consistent with guidance, however, DWI would like more attention to be given for telemetry failures.

Disinfection Strategy at 11 Water Treatment Work's Commended. Insufficient weighted evidence to give it a Legal Instrument, scheme commenced.

Eastergate and Westergate Schemes Both Declined to Support – DWI want to see robust validation of proposals, demonstrate benefit of each solution. (Subsequent to meeting support confirmed).

Feedback for next meeting.

MP

Doug Hunt asked for formal wording on this for inclusion in the CCG Report.

Milo Purcell advised that conclusions, challenges, would be available at the beginning of November and can provide CCG with draft report. The formal DWI letter can be appended to the CCG Report.

MP

David Howarth advised that the Environment Agency are preparing a report on the Company's Business Plan which will be sent to the Company this month for comments, this could also be appended to the CCG Report.

DH

9. **Customer Preferences**

Nick Sheeran circulated a paper detailing Customer Preferences and how they have informed the Company's Outcomes.

He explained that the table within the paper mapped out the key messages which have been forthcoming from the Company's Customer and Stakeholder engagement and how these have been translated into the Outcomes or 'Commitments' set out in our Draft Business Plan.

As there was quite a lot of detail for the CCG to digest it was agreed that the paper would be circulated with the minutes of the meeting for the CCG to consider and challenge at a later stage.

AD/CCG

10. **Any Other Business**

Update on Customer Research & Peer Review

Nick Sheeran advised that both results were due by 31 October 2013 and confirmed that good progress was being made. The meeting of the Sub Group would be held on 8 November 2013 and Doug Hunt and David Guest had been invited.

Annual Corporate Water Risk Conference

Richard Harris advised the CCG of an Annual Corporate Water Risk Conference being held next year that may be of interest. Amy Denford agreed to circulate the details to the CCG.

Other

Jon Stuart emailed the Secretary ahead of the meeting to ask for the Company's 'take' on Ofwat plans to block the proposed Thames Water price rise. Neville Smith confirmed that Company had no comment to make.

He also asked for the Company's view on the possible impact of the failing of Smartsorce Water. Paul Barfoot advised the CCG that Smartsorce Water were a Company who administered water bills on behalf of Customers who had recently gone into liquidation. He confirmed that the Company only had 11 Smartsorce Water Customer's, none of which owed any money to the Company. Paul Barfoot confirmed he would formally reply to Jon Stuart.

PAB