

PORTSMOUTH WATER Ltd
CUSTOMER CHALLENGE GROUP (CCG)
MEETING HELD ON WEDNESDAY 10 SEPTEMBER 2014

PRESENT: Jim Barker (Environment Agency), Charles Burns (FSB), Amy Gallop (Secretary), David Guest (Independent Chairman), John Havenhand (Consumer Council for Water), Mike Kirk (Portsmouth Water), Terry Lazenby (Portsmouth Water), Steve Morley (Portsmouth Water), Simon Oakley (Chichester District Council), Nick Sheeran (Portsmouth Water) and Neville Smith (Portsmouth Water).

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<p>1. Apologies:</p> <p>Traci Baker (Hampshire Chambers of Commerce), Hugh Caley (Carillion), Daire Casey (West Sussex County Council), David Collins (Havant Borough Council), Cllr Paul Dendle (Arun District Council), Keith Evans (Fareham Borough Council), Karen Gibbs (Consumer Council for Water), Richard Harris (West Sussex Hospitals Trust), John Hall, (John Hall Consulting), David Howarth (Environment Agency), Douglas Hunt (Atkins Independent Reporter), Derek Kimber (Gosport Borough Council), Douglas Kite (Natural England), Chris Manning (South Downs), Kirk Phillips (Winchester City Council), Milo Purcell (Drinking Water Inspectorate), Ian Rawson (KWS -Defence) Tim Richings, Charlotte Rose (Natural England), Jon Stuart (Havant & District Citizens Advice Bureau) and Rob Wood (Portsmouth City Council).</p>	
<p>2. Minutes & Actions of Meeting Held on 9 June 2014</p> <p>The minutes were taken as a correct record subject to a minor name amendment and approved by the CCG.</p>	
<p>3. Update on Draft Determination</p> <p>Nick Sheeran advised the CCG that Ofwat's Draft Determination overall was a good result and summarised the following highlights;</p> <p>The Company is the only company to receive slightly higher revenue proposed in its plan.</p> <p>The Company plan assumed a Small Company Premium of 0.5% to reflect the challenges faced for a smaller Company to borrow money. Ofwat recognised it was an issue but only allowed 0.15% resulting in a loss in revenue of £2.1m over the 5 years. However, it was good to get the principle that the Company was due a Small Company Premium as only two Companies achieved this.</p> <p>The Company plan proposed a Totex allowance of £137m and Ofwat increased to £140.7m which offsets the money lost on the Small Company Premium.</p> <p>Jim Barker asked what the Company will be doing with the extra money Ofwat are allowing. Would Customers get a windfall?</p> <p>Neville Smith advised that it was too early to take a judgement and the Company needs to await the Final Determination.</p> <p>Nick Sheeran reminded the CCG that this Determination is a Draft and it can still change ahead of the Final Determination published in December. He further advised that Ofwat are still looking at the cost of debt and their views may change on this and other factors that could still impact on the allowed revenue.</p>	

4. Performance Commitments / Outcome Delivery Incentive's

Steve Morley circulated a paper on what Ofwat's Draft Determination said about the Company's Performance Commitments / Outcome Delivery Incentive's and how the performance will be reflected.

Steve Morley reminded the Members that the Company initially proposed their Incentives and they had been shaped throughout the CCG process as the Company responded to what Customers viewed as important.

Steve Morley highlighted two key differences between the Plan submitted in June and where Ofwat are now as follows;

1. The Company proposal was to be judged over a whole five year period rather than annually. However, the Company only worked Incentives out annually and therefore Ofwat have said Incentives need to be five times greater.
2. The proposal started with Company specific Outcomes relating to the following:
 - a) Interruptions to Supply
 - b) Water Quality Contacts
 - c) Drinking Water Compliance
 - d) Leakage

However, all Companies ended up with similar measures. Ofwat have therefore intervened and stated that nobody should receive a reward for these Company specific Outcomes if their performance is not in the performance upper quartile for regardless of what is proposed in their Plan. This should have no impact on the Company already ranked in the upper quartile; however, Ofwat have yet to decide on how to rank leakage which could have an impact.

John Havenhand questioned if Ofwat really reduce everything down to money and economics?

Steve Morley explained that the Company originally based its incentives on reputation but Ofwat's view is Companies need a financial incentive to drive things.

John Havenhand commented that Companies who are focused on the Customer do not need to focus on the money and economic side.

Terry Lazenby commented that the focus will be on the penalties to ensure we avoid them to benefit the Customer. The magnitude of the penalties is much greater.

Simon Oakley asked how a price difference between money invested versus penalty would be viewed.

Neville Smith explained that the Plan has been prepared so the investment proposed will ensure the Company meet the targets and avoid penalties. However, for uncontrollable events or one off occurrences the Company would invest in what is needed to avoid deterioration and failure which customers wouldn't pay for.

Mike Kirk commented that the measure over five years, looking at the long term, benefits Customers rather than excessive spend for single year.

Jim Barker asked how Ofwat have intervened with the leakage target. Neville Smith advised that the target remains unchanged and in-line with the Company's Water Resources Management Plan but they have increased the penalty per failure by five.

Steve Morley circulated Commitments and explained how the process works. The objective is to invest in assets to maintain target. If the Outcome over five years exceeds target the Company would receive a reward at the next review. Penalties are much greater in magnitude than reward. Only when outside tolerance band would impact on customer bills.

David Guest asked what chance there would be of getting a penalty for burst mains.

Steve Morley stated the trend was downwards over time with the last occurrence in 2006.

Neville Smith advised that rewards were based on WtP not on cost of repairs.

Terry Lazenby further advised that rewards are capped.

Steve Morley confirmed that if the Company received maximum rewards bills would be 0.6% higher, 60 pence. If we received maximum penalties bills would be 2.4% lower, £2.40.

Steve Morley advised that penalties were about three times greater than the rewards.

Steve Morley informed the CCG that Ofwat have intervened on the water quality measure and changed from a five year average to a spot year.

Neville Smith confirmed that the Company need to challenge Ofwat on this as they believe it to be a mathematical error. This change poses a significant risk to the Company as some water quality failures are at the customer tap and out of the Company's control.

Terry Lazenby further explained the reason why the Board believe an error has occurred, advising that Ofwat use different units within their Report so need to get clarification from Ofwat.

Steve Morley confirmed that a working level meeting is scheduled with Ofwat for 19 September and this will be raised then.

Simon Oakley commented that when communicating water quality information to Customers Mean Zonal Compliance will not mean anything.

Neville Smith agreed and commented that other literature says compliance with water quality standards which may be more understandable.

Steve Morley explained that 40,000 random water tests are carried out per year with a target pass rate of 99.97%.

David Guest questioned how confident the Company could be at achieving such a high pass rate.

Steve Morley confirmed that the average in previous years has been 99.96%

David Guest questioned if the Company can put control measures in place to ensure figure/target met.

Steve Morley explained the control measures in place.

Neville Smith commented that there had been three failures so far this year and 2 out of the 3 were the result of customer behaviour, one had a water softener the other had a contaminated tap and the third had a lead pipe.

The CCG discussed this at length and thought the Company were being penalised for something outside of their control however Neville Smith advised that this was the standard set by DWI.

Simon Oakley suggested the only control measure the Company could take would be to educate Customers.

Neville Smith advised that the information was available on the Company's website.

David Guest commented that Customers need to be made aware of the advice available.

Simon Oakley recommended piggy-backing onto the Council's Public Health responsibility.

John Havenhand asked which penalty is of most concern.

Steve Morley advised that the Company is not concerned that the Plan will not deliver.

Nick Sheeran advised that the Company proposed in its initial Plan to share 50% of any return greater than 6% on average over the period with Customers. However, Ofwat's Draft Determination states that this mechanism is not consistent with incentive based methodology and could duplicate other rewards. The Company would therefore propose to remove the reward in its Representation to Ofwat on 3 October.

Neville Smith explained that this proposal was put in the Plan right at the beginning of the process; before rewards and penalties were introduced. Looking at it from a Shareholder perspective, they might now feel they are taking a bigger risk as the rewards are small and penalties are big, so with their risk increasing they will not want to give away 50% of any possible return at the other end too.

John Havenhand agreed with this argument as it was proposed before Incentives came in.

Neville Smith further added to the reasoning advising that Customers will benefit from Incentives by reduced bills in long term.

John Havenhand reiterated that he could see the Company's argument but would have preferred Ofwat to reduce penalties and rewards, not lose it at the other end.

Simon Oakley asked if the threshold had ever been exceeded and Neville Smith confirmed it hadn't.

Steve Morley asked the CCG to consider the following issues in their discussion later in the meeting and report back to the Company:

1. Views on:
 - a) the balance of the package;
 - b) the magnitude of rewards and penalties; and,
 - c) the horizontal consistency checks.
2. Challenge from Ofwat re retention of F1 - the profit sharing mechanism

5. Proposed Customer Research

Steve Morley informed the CCG of the following three issues that Ofwat's Draft Determination identified as needing further evidence of customer support:

1. Return on the Regulatory Capital Value;
2. Rewards & Penalties;
3. Non-Household Engagement,

The following Customer Research is therefore proposed:

1. Return on the Regulatory Capital Value

The Company will engage with Customers to provide evidence to demonstrate Customer support for the uplift in the Company's Weighted Average Cost of Capital which recognises that the Company faces a higher cost of raising debt than the Industry as a whole. The Company proposes to undertake quantitative research with 400 telephone interviews.

2. Rewards & Penalties

The Company will engage with Customers to confirm that 5 year averages are more appropriate than other options including an annual adjustment. The Company will use a Survey to establish this research with input from CCW.

3. Non-Household Engagement

The Company will engage with the CCG and ideally local non-household Customer Groups as well, on the potential for price controls to be set for a five year period or change the form of control to a short period. The Company therefore proposes to establish a relevant Sub-Group from the CCG to progress this issue.

Steve Morley welcomed volunteers from the CCG to join the Sub Group.

Neville Smith advised that the Sub-Group should consist of large customer members, Local Authorities, the Federation of Small Businesses and CCW.

After discussion with the CCG it was agreed that Steve Morley would invite these relevant Members of the CCG and the Sub-Group would not formally meet due to time constraints and diary commitments, it would all be done via email.

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6. Assurance Plan

Steve Morley informed the CCG that prior to the draft Determination Ofwat had written to the Company highlighting concerns over the quality of some of the information provided to Ofwat. He advised that it was more focused on the assurance required for the Company's response to the Draft Determination rather than the revised Business Plan. The three areas identified and confirmed in the Draft Determination are;

1. Financialability
2. Cost Allocation
3. FD09

Steve Morley circulated a report detailing the way the Company and the Board propose to respond to Ofwat.

Nick Sheeran informed the CCG that when the Plan was submitted in June there was no external assurance given, therefore Ofwat require further work to satisfy this. He confirmed that three external bodies had been appointed to provide assurance to the Board in these areas and the first draft is expected to be received on 15 September 2014.

David Guest asked if the CCG would have sight of this assurance.

Nick Sheeran reiterated that financeability is outside of the CCG's remit however, the Company has been transparent throughout the process.

Terry Lazenby suggested sharing any major issues that the Company did not expect with the CCG. He also reminded members that Doug Hunt of Atkins would be involved and could therefore inform the CCG of any matters of interest.

The Company Representatives Left The Meeting

7. CCG Discussion

Non-household Engagement

David Guest reminded the members that Ofwat have raised the potential for price controls to be set for a five year period or change the form of the control (to a short period) to allow companies greater time to consider and address any issues it has with its tariff proposals. He asked the members for their initial views on shortening the price review period.

Simon Oakley raised concern that reducing the period could impact on Commercial / Large Customers in their own business planning, looking over the longer term.

John Havenhand commented that if the Company feels two years is better than five years, CCG should support that.

Jim Barker raised concern that if the review remains at every five years when Competition comes in there is a risk that the Company could lose a significant number of their commercial customers straight away and domestic customers would be left paying for the commercial side and a mechanism would need to be put in place to avoid that.

David Guest commented that the Company welcome the establishment of a relevant sub-group from the CCG to progress this issue and was concerned over the time it would take to coordinate such a group.

Rewards and Penalties

David Guest reminded the members that the Company's Rewards and Penalties package looks at performance over the five year period to establish performance and the associated financial impacts. However, Ofwat expect the Company to engage with its Customers to confirm that 5 year averages are more appropriate than other options including an annual adjustment. He welcomed the Members views on this.

Jim Barker raised concern that if after the third year during the period it looks unlikely that the Company will meet their targets they meet give up in the fourth and fifth year. It could therefore affect their behaviour.

John Havenhand explained that the Company will have good and bad years, above and below target but the idea is that they should level out over the five year period. If measured annually the Company could be hit by one-off occurrences.

Jim Barker commented that if the Company were measured annually it would not impact on bills each year so from a customer point of view does it really matter and as long as behaviour does not change and the Company do not become complacent it should be fair and acceptable.

John Havenhand expressed confidence in the Company's long term planning and raised concern that annual measures would refocus the Company on short term plans which would not benefit customers.

Jim Barker suggested as a middle ground could the CCG recommend the Company publish their performance against targets annually to inform customers of their current position and receive the rewards and penalties at end of five years so they cannot hide their performance behind an average.

The CCG concurred with Jim Barkers suggestion and agreed to feed it back to the Company and ask them where they would publish this information.

Jim Barker commented that the Company highly value their reputation so publishing their performance annually would be another incentive / driver.

Simon Oakley requested clarification from the Company on what the impact of the Company's 5 year average performance would have on customers during the next Price Review period. Would it be applied to customers bills in year six or spread over the next AMP. The CCG agreed this would be a good question to raise with the Company.

Future of the CCG

David Guest informed the CCG that he had sight of the new Terms of Reference for Affinity Water's new Customer 'Scrutiny' Group and advised that a copy would be circulated with the Minutes of the Meeting.

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John Havenhand commented that he disliked the word 'scrutiny' as it dilutes the purpose of the name 'challenge'.

Jim Barker suggested that this name may be for a different formation of group, just for this 'peace' period monitoring the Company inline with its Business Plan proposals over the next five years and then change again at the next Price Review.

David Guest informed the CCG that another company had chosen the new name 'Customer Panel'. He further advised that the Company has confirmed that they wish to take the CCG forward but have not considered the remit; this may be decided after the Final Determination.

Simon Oakley commented that 'scrutiny' sounds appropriate for the role of the successor group.

John Havenhand expressed that the Group were more Stakeholders than 'Customers' and 'Scrutiny' sounds like the Group would be scrutinising processes and technicalities and therefore felt it was not appropriate. He stressed that the Group needs to ensure the Company is challenged by Customers. Some Companies are process focused; not Customer focused, and feels that the Group should continue in the same format ensuring Customers are the key drivers going forward.

David Guest advised that South East Water were excluding Regulators from their Group's going forward.

John Havenhand commented that the structure is not the issue, just who is included needs to represent customers.

Jim Barker emphasised that the Regulators benefit from being Members as the CCG is a great intelligence for them and they can add value.

Simon Oakley commented that the membership should stay the same as they have gained an institutional knowledge and will not be starting from scratch at the start of the next Price Review period. He also expressed his appreciation for the involvement of the Regulators and found the independent view from Statutory Bodies invaluable.

David Guest advised that the remit of the future CCG and the frequency of their meetings should be refined closer to the Final determination.

Jim Barker asked if the CCG were expected to make a response to Ofwat on their Draft Determination.

David Guest confirmed that he would find out at his CCG Chairs meeting on 11 September: Post meeting note – a covering letter from the CCG would accompany the response.

The Company Representatives Re-Joined The Meeting

8. CCG Feedback To Company

Rewards and Penalties

David Guest informed the Company that the CCG had discussed their views on whether measuring the Company on 5 year averages was more appropriate than annually.

On behalf of the CCG Jim Barker suggested to the Company that they publish their performance against targets annually to inform Customers of their current position and receive the rewards and penalties at end of five years.

Neville Smith agreed that this was a good idea and that the Company would do this. After further discussion it was agreed that the Company would publish this on their website and with their Annual Report and Accounts and Risk and Compliance Statement.

Terry Lazenby suggested doing this for 2014/15 then the CCG can comment if they are happy with the way the information is presented and if it is suitable going forward.

John Havenhand requested clarification on how the adjustment would take place after determining the 5 year average. Would the impact on price spread?

Steve Morley confirmed that the impact would take effect from day one of the next review period ie 1 April 2020.

Future of the CCG

David Guest asked the Company how the CCG engagement would continue going forward maintaining challenge and advised that the Members did not have much support for changing the name to 'scrutiny'.

Nick Sheeran advised that the Company will consider further to ensure engagement continues and doesn't envisage the name changing.

Mike Kirk commented that the Regulators involvement has proven beneficial for the Company as well as CCG Members.

Neville Smith emphasised that the trick is to keep people involved and interested and the Company would be giving this some thought.

Performance Commitments / Outcome Delivery Incentive's

David Guest raised concern that the request for volunteers for two new Sub Groups on the Biodiversity Action Plan and Retail Developer Satisfaction Survey would be challenging.

Steve Morley explained that the Biodiversity Action Plan would need to be endorsed by the CCG and he thought relevant Members of the CCG would like to be on the Sub Group.

Terry Lazenby suggested preparing the Biodiversity Action Plan and sending it via email to the relevant Members of CCG for comment.

Steve Morley agreed to take the Biodiversity Action Plan forward this way and the same with the Developer Satisfaction Survey which Karen Gibbs had already expressed an interest in.

Nick Sheeran asked if the CCG had discussed any further the Company's proposal to remove their commitment to share 50% of any return greater than 6% on average over the period with Customers.

John Havenhand confirmed that he understood the Company's reasons for removing it but as it was something Karen Gibbs had asked the Company to include in the Plan they should discuss with her first.

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Steve Morley agreed to discuss with Karen Gibbs outside of the meeting.

Neville Smith confirmed that if Karen Gibbs had a real strong objection the Company would reconsider.

9. Timetable

Nick Sheeran updated the CCG with the significant dates between now and the submission of the Company's Representation on the Draft Determination to Ofwat in October.

11 September	Company Meeting with Economic Insight to establish if it is worth them preparing a Report on Input Price Pressures
15 September	Receive Draft Financeability Assurance Report from Nera
19 September	Representation Meeting with Ofwat
22 September	Feedback Company Comments to Nera
26 September	Receive Report on Customer Research from Accent
29 September	Receive Final Financeability Assurance Report from Nera
3 October	Submit Representation to Ofwat
TBC	Atkins Report on Assurance Work
12 December	Ofwat Final Determination

Nick Sheeran further advised that the Company was unsure what would happen between submitting the Representation to Ofwat on 3 October and receiving the Final Determination on 12 December 2014. However, he confirmed that the Company would keep the CCG informed of any progress.

Neville Smith requested should the Chairman be informed of an expectation from Ofwat for the CCG to submit a report or a letter on the Draft Determination to keep the Company updated so they can provide whatever is needed to assist. David Guest advised that he had a meeting with Ofwat on 11 September and would inform the Company of any such expectation.

10. Any Other Business

Terry Lazenby advised that he will be retiring as the Company Chairman on 30 September and took the opportunity to express his thanks to the CCG for the

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valuable input into process. He further advised that upon his retirement, Mike Kirk; a current Company Non Executive Director, would be appointed as Chairman.