

28 August 2024

David Black
Chief Executive Officer
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By email: David.Black@ofwat.gov.uk

Dear David,

We are writing on behalf of the independent WaterShare+ Customer Panel to respond to your Draft Determination in respect to South West Water/Bournemouth Water/Bristol Water.

Our role

You will recall that the Panel wrote to you on 7 November 2023 regarding the Business Plan proposed by the Company. As we set out in that letter, the WaterShare+ Panel had a material influence on the development and content of the Business Plan to the benefit of customers. This included unprecedented access to the senior executive team, the board, the Company's independent advisors and auditors, and the customer research (including being able to materially influence its design and attending several research focus groups). The Panel's in-depth scrutiny and challenge covered areas such as performance, assurance and affordability as well as environmental and business planning activities.

In addition to specifically PR24 focused work, we also hold regular online and in person meetings with customers where we enable them to hold the CEO and other executives directly to account, a more in depth and regular equivalent to Ofwat's 'Your Water, Your Say' sessions. The Panel maintains an Action and Challenge Log to keep a record of all questions, comments, information requests and issues raised during scrutiny of the Company's operations and performance. The Action and Challenge Log was started in December 2022 and has recorded 453 actions and 207 challenges to date. The issues covered by the Panel discussions cover all aspects of Company operations that affect customers. These range from water quality and pollutions to executive bonuses and shareholder dividends. The Panel regularly addresses customer-specific issues such as seeking and listening to customer feedback; protecting vulnerable customers; affordable bills and improving communications with customers. This all fed into our input on the new Business Plan.

Our conclusion was that we considered that the Business Plan represented a plan to deliver the best value investment to meet the evidenced priorities of customers and the environment, while remaining affordable for all through key actions: the proposed increases to the Company's social tariff and other support schemes underpinned by a unique commitment to eliminating water poverty; continued incentive outperformance sharing with customers and progressive charging innovations; as well as the significant efficiency savings built into the plan to keep down costs, a high and very demanding level of efficiency challenge. We note that not only was the plan rated as outstanding, but the bill increases were the third lowest in the sector for water and sewerage companies, despite very significant increased investment in customer priorities.

In this context and given our own input, we were naturally pleased to see that South West Water achieved an Outstanding Quality and Ambition rating for its PR24 Business Plan, building on its similar track record in PR19 and PR14. This rating gives us confidence in our own assessment of and our influence on the plan - that the Company put forward a sector leading Business Plan centred on the priorities and preferences of customers, which are of course the focus of all the work of the Watershare+ Panel.

We note that at this time of fragile consumer confidence it is vital that the Company is tasked with delivering against promises and restores customer trust. The Company needs to be adequately funded and set stretching, yet achievable performance targets to be set up to succeed – and that this must be focused on the priorities of customers and with clear means to hold them to account for delivering on it (of which accountability we are a key part). Therefore, we welcome the fact that the draft determination has retained the vast majority of investments set out in the Business Plan and tested with customers.

That said, it is notable that Ofwat has nonetheless made significant proposed changes. Our response to the draft determination focuses on a number of significant concerns for the Panel with regard to how some of the changes outlined in Ofwat's Draft Determination could have a negative impact on customers and/or are not aligned with what customers have told us they want. The remainder of this letter sets out those areas of concern which we ask Ofwat to review and address.

These concerns are summarised as follows and are described in more detail below:

- Intergenerational fairness
- Reductions in nature recovery allowances
- Leakage reduction
- Isles of Scilly sewerage funding
- Price control deliverables
- Bristol Water bill profile anomaly
- Outcome delivery incentives

Intergenerational fairness

The Panel understands the concern about bill increases and the wishes to ensure that customers do not face bills higher than needed to meet statutory and regulatory requirements, plus customer supported priorities. On the face of it, a bill reduction for customers whilst maintaining deliverables compared to the Business Plan is welcome, and the headline impact of lower bills naturally gets support. However, customers were clear that reducing bills in the next five years should not come at the cost of overly burdening future generations. Ofwat has proposed significantly adjusting the RCV run off rate from c.4.6% to c.4.2% for SWB in the draft determination. This has deferred £125m of revenue from 2025-2030 until after 2030. The Company analysis we requested on the impact of this shows this deferral of revenue and bills to the future will increase bills over 2030-2050, a time period where further enhancement investment and bill increases can be expected as indicated in the Company's Long Term Direction Statement. In addition, the total amount that customers pay over the period is higher due to investment staying with the RCV for longer – approximately a £60m additional cost to customers over time.

Company priorities research demonstrated that customers want to see the investment programme smoothly paced to achieve fair and affordable bills over the long term. For example, research undertaken in September 2023 showed that 57% of SWW customers considered a steady programme of investment over 25 years to be preferable to front or back end loaded programmes (62% Bristol). Amongst those with the lowest incomes, 50% preferred a smooth programme, 25% front ended and 25% back ended. The Company paced their investment smoothly to reflect these preferences and ensure that investments to deliver against the highest customer priorities are delivered first. This smoothed profile approach to investment strikes the best balance between

environmental improvements and affordability.

A summary of this research, together with additional research on the same topic is given in Appendix 1. This extensive customer research showed the Panel that customers here want intergenerational fairness in allocating costs appropriately. The research was very clear about this.

We are therefore concerned that the transfer of finance of AMP8 schemes to future generations does not meet this test. The evidence for this is shown in the appended affordability and acceptability research with customers - there was a clear preference for the bill increasing sooner rather than later based on spreading increases fairly across different generations of bill payers¹. Panel members observed customer focus group discussions with both current and future bill payers which formed part of this research and so can confirm that customers showed strong support for this principle.

We ask Ofwat to reconsider this balance in the context of the customer research evidence at Company level supporting the balance put forward in the Company's Business Plan.

Reductions in nature recovery allowances

The Panel noted significant reductions to proposed allowances in this area in the draft determination. Overall, the nature recovery programme funding has been reduced by 16%, on top of the Company's own efficiency challenge of c.17% whilst maintaining deliverables.

The Company level research suggests that customers here would strongly object to a downgrading of environmental priorities:

- 'Boost nature and wildlife' was customer's 5th top priority.² Nature is growing as a priority for customers as more and more learn how much nature provides gifts every day to all of us, providing solutions to many problems. Customers said they understand that nature helps reverse climate change and supports net zero, provides life's essentials and can stimulate our senses, improve our wellbeing, and boost prosperity. This is an important area for stakeholders, who want nature-based solutions to be a key strand to environmental approaches, and for the Company's plans to deliver significant biodiversity and environmental ambitions.
- Many of the Company's stakeholders believe that enhancing the environment should be the company's highest priority.³
- When testing their WINEP plans, customers told the Company that they need to do more to protect the environment from future challenges. A particular focus is on boosting nature and improving bathing water quality. Customers stated they were willing to pay for these benefits – seeing it as short-term pain for long term gain – and that delaying investment until later just makes it more costly in the long run.⁴

In addition to the Company's own research, CCW research published in January 2024 demonstrates that households would be willing to pay up to £40 a year more on their water bill to use nature instead of man-made materials to improve river water quality and reduce the risk of flooding, increasing the role of nature in tackling water challenges.⁵

We interrogated the Company on the funding reduction in terms of potential impacts on delivery of

¹ Affordability and acceptability testing focus groups – July and September 2023

² PR24 Customer Priorities Report – September 2023

³ Let's Talk Water – Stakeholder Workshop, December 2022

⁴ Environmental priorities – WINEP focus groups – September 2022

⁵ Keen to go Green? Customer preferences and priorities for waste water solutions (CCW) – January 2024

what were high priority measures for customers for which customers expressed clear willingness to pay in line with the Business Plan. We also sought advice from our external advisers from the Environment Agency to test this concern.

Notably the Panel heard from the Environment Agency that cuts in allocation for Drinking Water Protected Areas and the control of invasive species (30% and 39% respectively) were of particular concern.

It is very clear from the customer research that customers in the South West care deeply about the natural environment and biodiversity and supported the proposals.

The Panel is concerned that with cuts of this scale will mean the Company will move to meet the challenge by delivering cheaper, less desirable solutions with less extensive collaboration. The Company shared the following examples:

- For WINEP drinking water protected areas (“upstream thinking”), the scope of the projects would need to be constrained and in particular, collaboration with environmental delivery partners on wider catchment management solutions (such as natural flood management benefits and nature-based solutions) would suffer.
- For Invasive Non-Native Species, there would be a need to limit the programme of testing and trialling new ways to control invasives and their potential to spread – this would be less rigorous and with reduced academic peer review, which would limit the ability of other water companies to replicate these techniques across the country.

Thus, the draft determination changes would tilt the balance against the priorities clearly expressed by customers for nature-based solutions. We ask Ofwat to revert to the approach set out in the Business Plan which was supported by customers.

Leakage reduction

Ofwat, like customers, sets a high priority on tackling leakage, and rightly so. ‘Reducing Leakage’ was customers 6th priority.⁶ Leakage is seen by customers to be a waste of water and money. Leakage is also a barrier to water efficiency messages working. It is a big ask to get all people to use less water – even more so when they see visible leaks left for days. We note however that customers are unaware of the leakage reductions that the Company have made over the last twenty years or that a quarter of leakage is from their own private pipes and plumbing. That said, with concerns about future water resources, willingness to pay to reduce leakage continues to be high.

It is in this area however that the Draft Determination is most challenging with a significantly increased efficiency challenge, which the Company has explained to us has derived from an industry standard unit rate, which focuses on least cost rather than best value solutions. This does not reflect the proposed programme of renewal for over 20,000 customer communication and supply pipes to address customer side leakage – as noted above, a quarter of leakage is from pipes owned by customers. It also does not align the WRMP methodology for long term best value leakage solutions. The concern we have – and which we discussed with our independent advisors - is that material cuts to the programme could lead the Company to deliver short-term interventions as opposed to longer term pipe replacement solutions. The Company set out to us how and why this would be, in all likelihood, the only way to meet the significant additional efficiency challenge imposed and maintain outputs. This would again potentially shift costs to future generations and have a negative impact on water resilience which is a key issue for customers.

⁶ PR24 Customer Priorities Report – September 2023

We ask Ofwat to fully engage with our local customer research to address this concern and we look for reassurance from Ofwat that this is resolved to meet the local customer evidenced priorities.

Isles of Scilly sewerage funding

Of the Company's request for £33m of investment for the implementation for a central wastewater system on the Isles of Scilly, only £11m has been allowed in the Draft Determination. This very significant reduction appears to be based on two assumptions: 1) the use of typical build costs on the mainland for similar schemes; and 2) direct comparison to first-time sewerage take up in similar schemes nationally. The Panel received clear evidence that neither is correct:

1) There are evidenced (and obvious) high costs associated with taking materials, equipment and specialised labour to the islands, and working in the very sensitive environment there.

The Company explained that unit rates are higher as the Company is operating in an island environment, where all material and equipment including for road resurfacing has to be shipped over. This often requires chartering specialist landing craft for large items. All waste material has to be shipped back again. This can lead to costs of four to five times the unit costs on the mainland.

2) Research has indicated that people on the Isles of Scilly will take up the sewerage provision at much higher than typical rates. Notably engagement has taken place with the Duchy of Cornwall, the main landowner on the island, who want all of their tenants to have mains sewerage.

The Company's research shows that customers on the Isles of Scilly support reducing the number of spills from storm overflows. They also reacted positively to plans to bring sewage treatment standards up to those of the mainland, as it made them feel less of a 'poor relation' in this regard. Nobody was surprised that sewage treatment standards on the Isles of Scilly lag the rest of the UK by 20-30 years⁷. The Duchy of Cornwall owns 100% of the properties on the three smaller islands and the Company have already received a request for first time sewerage from the Duchy for 185 (100%) of their properties on these islands.

The Panel is particularly concerned that the result of the changes in the draft Determination could be that an inadequate system is put in that won't fully meet future needs nor the current aspiration of the customers, which would have longer run negative impacts on customers and the environment of the Isles of Scilly and would not reflect the priorities evidenced by the customer research. We believe Ofwat needs to review the basis for the changes in the draft determination so that the plan reflects the evidenced customer priorities in this regard.

⁷ Testing the PR24 Business Plan – September 2023

Price control deliverables

We welcome Ofwat's focus on making sure that companies deliver the improvements that customers are paying for. We have intensively discussed the key ways that Ofwat propose in the Draft Determination to do this through Price Control Deliverables. Our observation is that the framework Ofwat propose appears very complex and will be difficult even for informed stakeholders to understand. We are concerned that the move away from outcomes (in previous price reviews) to an output-based approach may in particular constrain ability to adapt to changes in need.

One area where flexibility will be especially required is in the storm overflow programme, which we know to be extremely important to customers. They rightly think storm overflows are being used too often and find this unacceptable. They believe these are having a large impact on public health and the environment and want to see investment. Ideally, they would prefer storm overflows to not be used at all, although in discussion they understand why they are needed⁸. The Panel therefore notes and welcomes that the Company has been fully funded to deliver its programme of storm overflow investment.

Of great concern to the Panel however is the evidence we received from the Company that the proposed price control deliverable framework for storm overflows is highly complex, consisting of 44 different measures focused on outputs. We are concerned that the focus on very detailed specific outputs and timings could create perverse outcomes with potentially negative impacts on customers. We were presented with examples of how the impact on the Company's ability to be flexible in its approach could potentially deter innovation, new methodologies and technologies that customers would welcome and that would benefit customers and the environment.

Even since submission there have been significant required changes to the programme, with the Environment Agency identifying c£90m of new obligations for storm overflows. The Company intends to manage customer bill impacts by working with the Environment Agency to identify changes to their programme to meet its obligations with a neutral approach to customer bills. In addition, we know that not only do new obligations arise, but specific schemes can be subject to delivery timing and content changes as they evolved. We were presented examples by the Company of how an inflexible set of highly detailed scheme by scheme PCDs could lead to less than best value and/or fail to deliver best outcomes.

We ask Ofwat to consider how suitable flexibility rooted in best outcomes for customers can be reintroduced. We propose that a better approach would be to enable decisions on how the investment is allocated to be managed locally providing the outcomes are achieved, subject to a role for the WaterShare+ Customer Advisory Panel together with public scrutiny meetings in reviewing any proposed changes to ensure they are subject to scrutiny and challenge locally, as well as by regulators. We would welcome Ofwat considering whether this approach would better meet its objectives to build stakeholder and customer trust in Company delivery.

Bristol Water bill profile anomaly

The bill profile for Bristol Water in the draft determination shows a c25% decrease in bills in 2025/26 with a corresponding increase in 2026/27.

Customer research was very clear that a smoothed approach to bill increases was preferred, which the Business Plan therefore proposed, and we supported⁹.

⁸ Environmental priorities – WINEP focus groups – September 2022

⁹ PR24 Customer Priorities Report – September 2023

We understand that the Company has been in communication with Ofwat to discuss the reason for this unexpected profile in the draft determination. The Company believes that this is an error and tells us Ofwat did not intentionally arrive at such a bill profile, and that they believe it will be corrected.

We support customers view that such a bill profile should be avoided and trust it will indeed be corrected to a smoother bill profile in the final determination.

Outcome delivery incentives

Ofwat has replaced the Company's proposed ODI incentive rates, derived from the triangulation of very extensive Company specific customer research, which we reviewed in detail during the business planning processes and was subject to extensive Panel challenge, with those derived from a single national study. We do not see how that single national study provides a good basis for the Ofwat draft determination overturning local customer preferences. Furthermore, its methodology delinks the research from the incentive rates derived.

We scrutinised the Company research submitted with its business plan on the strength of performance incentives, and believe this research is well-founded and reflects customer views. On this basis we ask Ofwat to make sure that both customer views on incentives, and the risks of an increasing cost of finance if this is set incorrectly, are reconsidered carefully ahead of the Final Determination. The key is to best incentivise the priorities customers have locally, which are of course the key priority of the customer Panel.

Customers are keen for incentives to be proportionate and to apply to factors which are within the Company's control¹⁰. We are concerned that the incentive rates set by Ofwat are disproportionate. For example, with reference to the water quality contacts PC the Company tells us that they will receive a penalty of c.£7,000 per customer contact for every contact beyond the target. This seems to us to be excessive, and it is not obvious to us how it is grounded in research.

The Company also tells us that there are no exceptions for factors such as third-party damage, for example damage to water mains by other utilities causing an interruption to supply. We ask Ofwat to consider the implementation of a process which enables a conversation around these third-party impacts and the extent to which they were reasonably within the company's control, on the rare occasion that they should occur.

The Company tells us that Ofwat has introduced an overall cap of c.£100m per annum to penalties that the Company can receive, but that the incentive rates are such that that cap can quickly be reached from only a handful of measures (with pollution incidents, leakage, PCC and external flooding having the highest levels of likely penalties). We are concerned that this could disincentivise actions once the cap has been reached, if there is then no benefit to further discretionary investment and therefore ask Ofwat to test whether the incentive rates work in the context of the overall cap and whether they are proportionate.

Customer representation and Challenge

The WaterShare+ Panel has had a material influence on the development and content of the South West Water Business Plan for 2025 to 2030. Whilst PR24 did not require this (unlike the two previous

¹⁰ Performance Commitments and Outcome Delivery Incentives Customer Research – April 2023

price reviews) we regard it as a very important part of the process, that has gone well beyond those carried out for PR19 and PR14 - both of which were regarded by Ofwat as exemplary.

During PR19 ICGs played a key role but Ofwat decided not to mandate their involvement at PR24. This was disappointing – especially after CCW's independent study found that ICGs are a valued source of customer challenge. We urge you to look at the successful WaterShare+ approach which has informed a sector leading business plan and hope that this will be extended as 'business as usual' for all companies in the new business plan period. We have welcomed South West Water's continued commitment to this.

We welcome the opportunity for the Watershare+ Chair to join members of the South West Water executive team for their meeting with Ofwat on 4 September 2024. If it is helpful to Ofwat, we would be happy to speak privately with yourself or senior colleagues at the end of the meeting, or at any other time to talk through our concerns and how they might affect customers. We are committed to continue to work on behalf of customers to ensure that any alterations to the Company's PR24 Business Plan continue to represent best value investment for customers and the environment.

The company's draft determination response

The company has shared with us its key areas of response and the customer bill impact of the revised plan which it will submit to Ofwat. We understand that broadly, the company intends to return to its original plan. This was a plan which was well supported by customers (74% acceptability) and the outcome of an extensive process of customer and stakeholder engagement, scrutinised and challenged by the WaterShare + Panel. We remain supportive of the deliverables in the original plan because they reflected customer priorities, and it is the above customer impacts of the changes made in the Draft Determination that we wish to specifically raise with OFWAT to resolve.

We understand that the impact of the company's response to the draft determination is the same as that of the original submission for South West Water and Bournemouth Water (£621 by 2030) and a small reduction for Bristol Water (£233 versus £238).

However, there is a 17% step up in the SWW bill between 24/25 and 25/26. This compares to around 9% in the DD (which also shows a step up in 25/26, but not to the same level) . The panel believes that such a sharp year one increase is not going to be at all acceptable to customers and other stakeholders. We ask that Ofwat works with the company to find a workable solution to smoothing the bill profile, whilst meeting the wider customer priorities outlined above.

Yours sincerely,

Matthew
Lord Taylor of Goss Moor
Chair, WaterShare+ Group Panel

Peaches
Peaches Golding OBE
Deputy Chair, WaterShare+ Group Panel

Appendix 1 – Customer views on long term bill profiles

The benefits of water company investments can last for generations, and capital investments are paid for over a long period of time via the Regulatory Capital Value (RCV), so there is a question about who pays for the work via how the RCV is allocated to different generations in way which represents the benefits received from investment. Ofwat required company Boards to provide assurance that company’s plans deliver fairness between current and future customers.

Company research consistently shows that customers prefer smooth, or even front end loaded bills rather than deferring investment and bill increases into the future. These views were particularly strong for future customers. A summary of research findings and links to relevant reports is given below.

Research headlines

- Intergenerational fairness is a key priority for SWW customers, who want to pass on a resilient infrastructure to the next generation. Research and engagement shows that customers and stakeholders do not want to see short-term cuts in investment at the expense of future generations, viewing this as a false economy. They believe the company needs to act now, especially around bathing water quality.
- Affordability and Acceptability testing shows that 73% of households feeling able to answer the question, prefer an increase in bills to start sooner, spreading increases across different generations of bill-payers. This compares to 27% preferring an increase in bills starting later, putting more of the increases onto younger and future bill-payers. This support for investment now is clear across all regions and segments, with support for starting sooner amongst those struggling to pay at 76%.
- Customers think that SWW’s plan is good for future generations – this is the most popular reason customers gave for supporting the proposed plan in the qualitative Affordability and Acceptability research, where the company was able to explore in-depth with customers to understand their views about our proposals. Members of the WaterShare+ Panel observed these research groups.

Evidence from research

Affordability and acceptability testing¹¹¹²

The purpose of this research was to test the acceptability and affordability of the company’s proposed PR24 plan with a cross-section of customers to inform how the plan was refined.

¹¹ [Affordability and acceptability testing focus groups, July 2023](#)

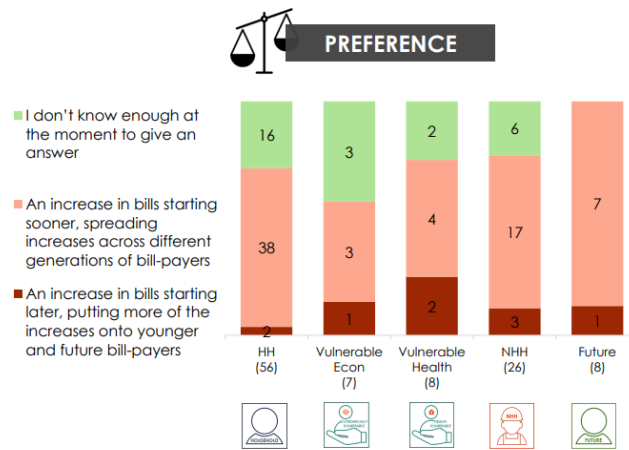
¹² [Acceptability and Affordability Testing – September 2023](#)

A mix of qualitative and quantitative research techniques were used to explore customer views. Around one third of customers did not feel able to answer the question. Of those who could answer, a significant majority preferred bill increases to start sooner, spreading increases across different generations of bill players. In focus groups, future customers felt particularly strongly about this.

Qualitative research

Summary: Preferred Phasing 23

Most customers interviewed would prefer seeing an increase in bills starting sooner than later, ie accelerate the investments.



Source: Appendix A, B/C, D, E: Long term investment by the water company will require an increase in customer bills. Bills could increase in different ways over time. For example, there could be increases now for current bill payers, or bigger increases in the long term for future generations. Which one of the following options would you prefer?



Quantitative research

Preferred phasing of water bill increase 10

There is a preference for the bill increasing sooner rather than later, though over a third give no opinion either way. Non household customers are more outspoken.

Which of the following options would you prefer?

- Starting sooner, spreading increases across different generations of bill-payers
- Starting later, putting more of the increases onto younger and future bill-payers
- I don't know enough at the moment to give an answer

Customer Segment	Sub-Group	Starting sooner (%)	Starting later (%)	I don't know (%)
Total HH & NHH	SWW (983)	36%	22%	42%
	BRL (716)	46%	15%	39%
	BW (682)	46%	17%	37%
Household only	SWW (776)	34%	17%	49%
	BRL (597)	46%	11%	43%
	BW (592)	44%	13%	43%
Household vulnerable	SWW (308)	44%	19%	36%
	BRL (231)	45%	13%	42%
	BW (243)	43%	15%	43%
Household struggling	SWW (97)	59%	16%	25%
	BRL (67)	39%	12%	49%
	BW (59)	49%	28%	23%
Non household	SWW (207)	38%	33%	29%
	BRL (119)	46%	26%	28%
	BW (90)	51%	26%	23%

Q9. Long term investment by [water company] will require an increase in customer bills. Bills could increase in different ways over time. For example, there could be increases now for current bill payers, or bigger increases in the long term for future generations. Which one of the following options would you prefer? **Base** Household and Non household bill payers: Total: SWW (983); BRL (716) BW (682) . **WEIGHTED % FIGURES ARE DISPLAYED and UNWEIGHTED BASE SIZES**



PR24 Customer Priorities research – September 2023

The purpose of this research was to test customer priorities for investment and their preference for investment profile over the long term.

When the company asked customers about how they would like the investment to impact the bill, 59% of customers have said that they want to see the investment programme smoothly paced. For customers with the lowest incomes, 50% prefer a smooth programme, 25% want this work to be front-ended and 25% back-ended.

Preferred investment approach by household income

