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Dear David

I write on behalf of the Thames Water Customer Challenge Group (CCG), in anticipation of Thames Water's response to Ofwat's draft determination. The CCG has considered the draft determination from Ofwat and would make the following observations. For completeness, the CCG should note that it has received a broad overview of Thames Water's response to the draft determination and its proposed alternative 'lower cost, lower investment' scenario. The CCG has not had the opportunity to review the alternative plan in detail and it has not been tested with customers.

Thames Water has told the CCG that the draft determination, as it stands, is undeliverable as the combination of cost/efficiency challenge coupled with more stretching performance commitments would set the company on course to fail across the board, and importantly in key areas where customers are seeking real performance improvements. The difference between what the company says it needs to deliver its April Business Plan and the draft determination is so significant that the company has sought to arrive at a lower cost plan that will move closer towards Ofwat's cost assessment. However, in doing so, the company is removing investment in a number of key schemes that contribute to the longer-term resilience of water and sewerage services that customers and stakeholders have called for. The CCG is not in a position to weigh up the two opposing positions on what is deliverable as they are largely down to differences in modelling and underlying financial assumptions. However, the CCG thinks it is important that it flags the concerns that arise from the information the company has shared with the Group so that Ofwat can take these into account before arriving at its final determination.

The CCG feels therefore that it should comment in three specific areas; first, discussing the question as to whether Thames Water's customers really did seek bill reductions (sometimes with the underlying assumption that service was likely to be reduced in order to deliver those), second, regarding efficiency and modelling, and finally, whether the CCG believes that what Ofwat is seeking from Thames is deliverable, particularly in key areas such as leakage, and what Thames's inability to deliver across the board under the terms of the draft determination would imply for customers.

However, the CCG would want to start by going back to the central role of the customer in this process. Over the last few years, both Ofwat and Thames have stressed the importance of listening effectively to customers and fully taking their views and priorities into account when building business plans and setting targets. CCGs were encouraged by Ofwat to tell Ofwat, how well companies had done this during the original submission stages. It seems to this CCG, however, that at this point in time, the essence of this process – listening to the voice of the customer - is in danger of being lost. Ofwat appears to be using an economic model to determine an ideal shape of the Thames plan without recourse to the customer input or insight that informed earlier versions of the plan. Although the CCG recognises that setting financial parameters does not necessarily dictate a company's precise approach, the scale of the intervention in this case inevitably has an impact on

what the company can do, (and therefore on how many tradeoffs or choices it can make), and how it fulfils customers' wants and needs as evidenced by its customer research and insight; Thames has constructed a 'lower cost, lower investment' scenario which fails to address some of the areas shown to be important to customers and stakeholders. Moreover, at this point, the proposed 'lower cost, lower investment' scenario has not been tested with customers for their validation. This is an especially important point if one considers that customers are actually seeking a basket of measures, combining a series of outcomes with a consequential price point and customer bill level (in contrast to determining a price point/cost assumption and then setting targets accordingly). The effect is to depart from the highly desirable aspiration of putting customers front and centre in the process.

It is worth reprising what customers said they wanted. The issue of price levels is discussed more below. Other key elements included predictable, reliable (and where possible) improving service, investment in key infrastructure, delivering future resilience, ensuring that challenges such as population and climate change could be effectively addressed, good support for vulnerable customers and thoughtful and effective stewardship of the environment. Thames are clear that the Draft Determination as it stands would see it fail across the board; its own suggested 'lower cost, lower investment' scenario sees it focus on the here and now and less on future investment.

Price and service

For completeness, the CCG has reviewed what emerged from Thames's extensive research regarding price and service. There was no real appetite across the research to see bills decrease and in fact when it was raised customers said they would rather see small bill reductions (e.g. from schemes that did not go ahead) reinvested to maintain/improve the service rather than have them as rebates. It is not clear, however, at what point customers would consider it "worthwhile" to have a price cut rather than that reinvestment.

To be specific regarding customer views on increased/stable bills; when presented with high level bill and service maintenance/improvement options in the spring/summer of 2017, 76% of customers preferred bills to stay the same with improvements to the service.

When asked to assess different packages of bills and service maintenance/improvements in autumn 2017, most customers favoured options that improved the service whilst either keeping their bill the same or increasing the bill slightly.

When looking at affordability, customers were presented with details of the March 2019 Business Plan for 2020-25, with a proposed average household bill profile that dropped by £5 from 19/20 and then remained flat from 20/21 to 24/25, with maintained/improved services. 87% of customers found the bills to be acceptable and 81% found them to be affordable.

All of this suggests to the CCG that customers did not view bill reductions of any dimension to be an imperative but that getting a sensible balance and enabling service improvements was by and large what they were seeking. This research is congruent with the CCG's observations at research groups that generally customers feel their water bill is relatively good value for money but that they want to see consistent/improving service.

The CCG recognises that Ofwat may, as the regulator, wish to take a strategic view that as an industry there should be declining bills overall; however, the CCG should stress to Ofwat that Thames customers at this particular point in time have not stated that substantial bill reductions are their highest (or indeed any) priority. There were some discussions of "doing more with less" but

those tended to be in the context of seeking further service improvements rather than price reduction.

Contrasting models

Turning to the other specific areas. There are questions around models and efficiency. At the outset, the CCG must say that it is impossible for it to judge the validity of Ofwat's model versus Thames's approach. The CCG is not set up to do this, nor should it be. It is for others to decide which is the more accurate and/or appropriate model to employ.

That said, it is clear to the CCG that there is (and continues to be) a substantive difference between the outputs of Thames's model and that of Ofwat. The outcomes that flow from the two models are therefore profoundly different, and this materially affects the assumptions surrounding, and the construction of, any business plan. As Ofwat noted in its Aide Memoire, though, it is "not for CCGs to provide assurance that all costs included in a company's business plan are efficient", however, it is noted that "CCGs may want to challenge company's costs in the customers' interests". The CCG did challenge such costs when appropriate, but it is fair to say that the scale of the difference was not apparent until the latter stages of the discussions.

Having said that, asking customers throughout the research programme to consider company business plans and outcomes which include cost assumptions which are markedly different from the Ofwat efficient operating model is not necessarily helpful and is not something that a CCG is really able to challenge during the engagement process with any credibility. Identifying the gulf between what Thames believed its costs *would* be and what Ofwat asserted they *should* be is something that needed to be recognised formally at a much earlier stage in the process so that customers have the chance to assess plans which recognise those cost distinctions and service outcomes and they can be appropriately researched. Had this been the case, the documentation that Thames provided to Ofwat could have reflected that difference. The Thames Water CCG has noted elsewhere that there would be merit in Ofwat setting down a prescribed protocol for acceptability research which gave consistency across companies (e.g. in terms of inflation assumptions) and the CCG would respectfully suggest that some form of prescription around efficiency assumptions during research would be of similar value. In short, therefore, customers have not had the opportunity to compare the two approaches. Arguably, it would probably not be a very fruitful research project at this point in time, given the dichotomy between the approaches and the understanding needed to make valid comparisons. However, the CCG is very concerned that customers have had no opportunity to express their views in what now faces them – three distinct possible scenarios - Thames Water's submitted Business case, Ofwat's Draft Determination and Thames Water's 'lower cost, lower investment' scenario developed in response to Ofwat's Draft Determination.

Deliverability and predictability

What is important to customers is that the service they receive should be utterly predictable and that Thames should take away waste and deliver clean water 24/7. They expect improving standards of response to issues and they expect that Thames will understand the challenges of the future and work to address them. Above all, when they considered the plan (both in its entirety and during research on individual PCs) the CCG believes they expected that it could be delivered in its totality, with perhaps the odd failure resulting in appropriate penalties. To the CCG this raises an important issue. Thames tell us that were they to accept the draft determination as it stands, they would be likely to fail across a wide range of metrics – many of those important to customers, such as leakage. To a lesser extent, even their 'lower cost, lower investment' scenario appears to have considerable

risk of operational failure in some key areas. And, to an extent, failure across a number of PCs in itself raises the level of financial risk. The CCG would suggest that neither Thames nor Ofwat have as yet considered what customers would feel about a company setting out with a plan that it knew to be undeliverable or at high risk of being undeliverable, which could well fail in key areas, and which would incur penalties across the board, or widely or in key areas, not just in the odd area. In the many research sessions customers were told that targets approved by Ofwat would be “stretching” but not undeliverable. The CCG considers this is important and that it goes against the much expressed views of customers that they want and expect solid, predictable service. It also mitigates against future strategic investment, as customers have repeatedly said that they do not believe new water resource schemes should go ahead until certain key metrics around leakage and PCC are delivered.

Environment and leakage

It is important to mention customer views around environmental issues. From the research perspective, customers have repeatedly said the natural environment is important to them. The CCG would also note that, since this research was undertaken, there has been an increased public mood of concern about the natural world (e.g. the recent IPSOS MORI survey on climate change and the impact of some factors such as *Blue Planet* and *School Strike for the Climate*). With such heightened awareness, customer concerns around the environmental risk that could result from lower confidence in delivery in both the draft determination and Thames’s proposed option could be significant - although it is important to note that customer attitudes have not been re-tested against the changing public mood. Thames’s comment “There is also an increased environmental risk, as our ‘lower cost, lower investment’ scenario places less emphasis on ‘slow-burn’, sustainable long-term solutions. This scenario therefore offers a lower level of resilience in the round, as a consequence of reduced totex” does not inspire confidence in this important area.

A few comments on leakage. According to Ofwat, Thames provided insufficient evidence in its April plan of how it would deliver on leakage. So even with the Thames-modelled cost base there were doubts about deliverability, which were underlined by the CCG in its April response, given the current performance and the depth of the aspiration. Now, in the 'lower cost, lower investment' scenario Thames are keeping to their April plan target, but with lower spend "broadly meeting" the Ofwat-modelled cost base, which Thames says increases operational risk. All this strongly suggests that on leakage customers will have an undeliverable plan. This goes against customers' insistence that leakage reduction be achieved before the development of new resources, contradicts the mutuality between customers and the company around water efficiency and leakage, and would damage customer trust and confidence.

In summary, the CCG has heard a clear message from Thames that it does not believe it can deliver the plan that Ofwat sets out in its draft determination; if this is management’s view, there is nothing for the CCG to add in terms of the merits of either argument and it is not for the CCG to decide between the quality of the differing models. The CCG has noted that Thames has set out an alternative approach; the CCG would commend Thames for seeking some sort of compromise but would express its concern that this ‘lower cost, lower investment’ scenario does not necessarily deliver what customers have said they want and that by its own admission the risks against successful delivery of key metrics are high.

Finally, the CCG has noted Thames’s concerns about revised metrics relating to the PSR and the CCG’s thoughts are set out in an Annex below.

I hope that this is helpful in setting out the Thames Water CCG's view on the Draft Determination and Thames's response to it. I am more than happy to discuss this in more depth if that would be of value.

Yours sincerely

Anne Heal

Chair, Thames Water CCG

Annex

Comments on PSR

The CCG understands that Ofwat has now set out its requirements of companies regarding the Priority Services Register. We understand that this includes a 50% response rate from a regular check in with customers. Thames has made representations to the CCG that this is too high and that around 30% would be stretching but more realistic. From the CCG members' own experience and knowledge, 50% would seem to be overly challenging. There is perhaps a linkage here to the earlier point made about delivery and the likelihood of success. There is a delicate balance between setting very challenging targets and setting companies up to fail. The CCG would urge Ofwat to ensure that the appropriate cross and pan industry learnings are fully considered before it finally sets this particular target.