



South Staffs Water

PR14 Update

CCG Meeting 13 June 2014



Overview – Status Update

Issue		Current Position on Amendments
	% complete	Issues
Small Company Premium	70%	Report to be finalised, survey results very positive (90%)
PR09 Legacy	100%	Submitted on 10 th June
Wholesale Totex	80%	Power costs claim submitted. Lower value claims to follow.
Retail costs – debt claim & future indexation	Debt – 80% Index – 60%	Oxera support progressing
Outcomes	95%	Positive Ofwat meeting on Tues 3rd June, commentary now circulated to sub-group and our Board
Financial Modelling	80%	Ofwat model working, need to review some assumptions
Affordability	90%	Results are 87% acceptance

Gap Analysis

- Submitted to Ofwat on Wednesday 11 June and circulated to CCG
- Follows several Ofwat meetings to gain further feedback and discuss our proposed amendments
- One more high level meeting on Tuesday
- Comments welcome, though presentation will cover each issue we have progressed and discuss where we will have more evidence than was the case with the December 2013 submission



Small Company Premium

Question

The water companies in the UK are a mix of larger companies and smaller companies. Your water company is one of the smaller companies.

Your water company believes that being smaller means they can provide you with a better level of service by responding to issues more quickly and tailoring their services to the local community. They are also more likely to employ people from their local areas and buy goods and services from other local businesses. Some relevant information on the service they provide is shown below.

SHOWCARD USED SHOWING COMPANY VS INDUSTRY SERVICE HEADLINES, PLUS OUR LOCAL EMPLOYMENT

Your water bill is lower than all of the larger water companies although some of the costs included in the bill are slightly higher due to the small size of the company. This cost has always been included in your annual bill and is £1.90 (average h'hold) which is already included in the plan presented to you in this survey.

Please indicate how happy you are to continue with this amount for your local water service?

Results

	Response
Very content / content	90%
Not content	6%
Don't know	4%
Sample	1,000

- Ofwat Info. Notice issued on 23rd May.
- Two meetings with Ofwat on this subject next week.



South Staffs Water

PR09 Legacy Adjustments

£1.8m higher than Dec plan:

	Value
Revenue (RCM)	£12.8m
Opex efficiency (OIA)	£3.9m
SIM (1 st in sector)	£2.8m
Capex (CIS)	-£4.2m
Tax	+£3.8m
Logging up/down	zero
Total	£19.1m

Points to note

- Submission made on Monday 9th June
(75 pages, tables, feeder models)
- Mike Reid (Monson Engineering) Assurance report available on our AMP5 outputs being met - hence no logging down.



Wholesale Totex

- £11m (3%) shortfall at RBR stage, despite our future totex (per prop) being 2nd lowest
- Positive meeting with Ofwat.
- Rank 6th on efficiency from last 5 years. 3rd from CEPA.
- Menu choice by Board in Dec/Jan (possibly a need to indicate after Draft Determination)
- Power claim discussed and evidence on this sent 3rd June as a model misrepresentation. Value of up to £14.8m from 2 components:
 - High pumping needs not fully reflected
 - Future costs higher
- Further submission on 27th June for special factors



Retail Costs

Debt Claim

- This relates to our retail costs being higher than if we had average levels of customer deprivation.
- South West claim generated from high bill rather than high deprivation. 80% of Welsh's claim accepted. Northumbrian withdraw their claim.
- Deprivation values from *Oxera* support our claim, looks like our Dec plan under-estimated the gap.
- Hence value of claim could be slightly higher (>£1m).

Future indexation

- This relates to whether future retail costs will rise.
- No allowance in four Draft Determinations to date (Welsh + Northumbrian withdraw their requests)
- Oxera appointed to present logic of need and our supporting evidence.
- Work is on-going to forecast cost increases in retail. We are different:
 - Deprived customer base
 - Already efficient
 - SIM



Outcomes

- Minor polishing on-going – seeking to accommodate Ofwat, CCG and Board feedback which unsurprisingly is not always consistent!
- Meeting held with Ofwat on 3rd June.
- ICS Consulting's review of our approach is positive, they did this in knowledge of Ofwat's approach to Welsh and Northumbrian (here Ofwat made quite notable changes).
- Ofwat guidance note issued – 7 principal areas to consider with emphasis on “stretch”.
- Draft commentary available (73 pages)



Outcomes: Amendments Made and Further Issues to Consider

Since last CCG

- Linear approach to application of rewards and penalty (rather than triggered at discrete bands)
- Slightly more stretch in some cases for when reward commences and our performance commitment (e.g. the two water quality measures)
- Long term leakage in AMP increments
- Reputational incentives developed with CCG sub-groups

Following Ofwat Meeting

- Licence application needed by us for annual rewards / penalties – Board will therefore revert to PR19
- Some individual penalties are smaller than rewards – logic explained or amended.
- Serviceability measure is clear but reward/penalty values look very low. Values now amended
- Reputational metrics – clear reasons on why a penalty is not needed



Outcomes – summary of financial incentives ahead of the detail

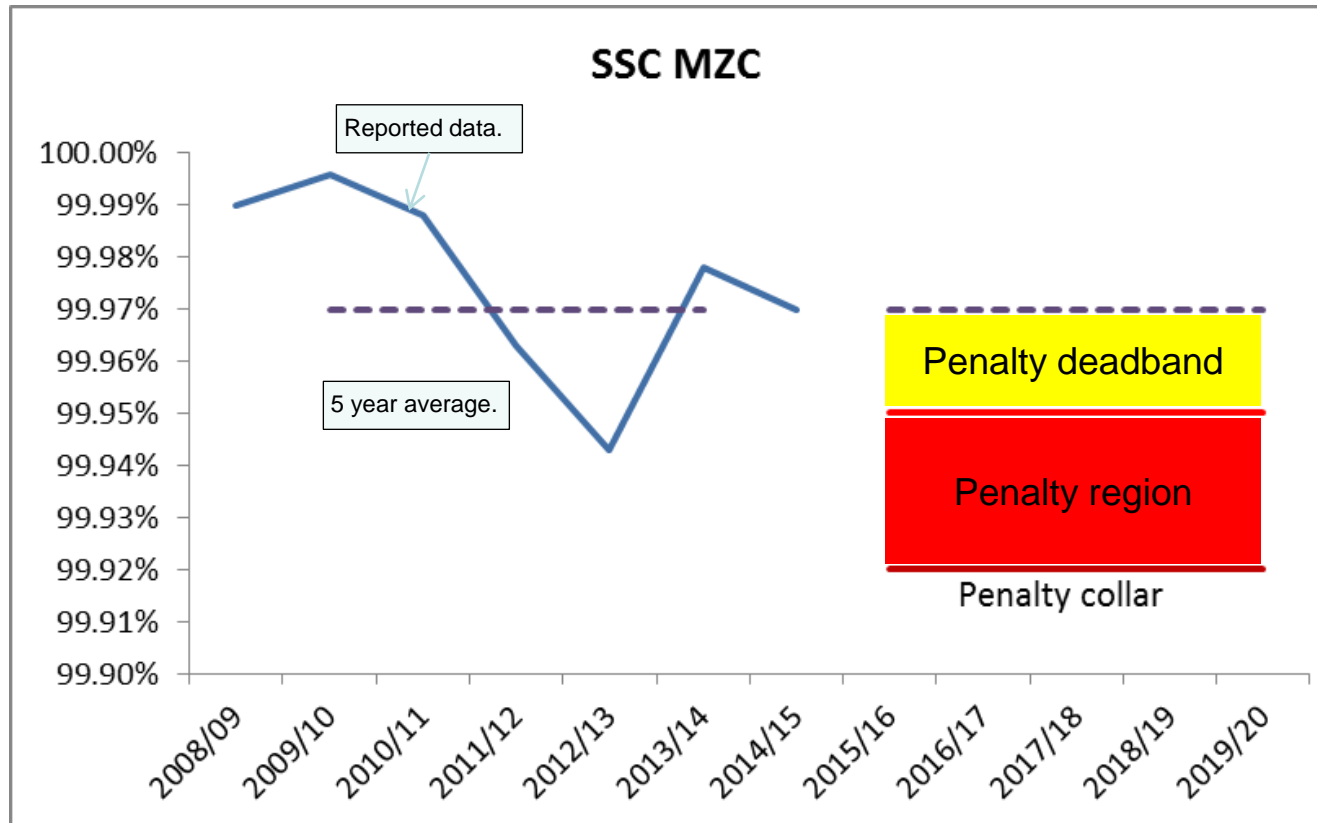
- The current position is:

	Maximum	Realistic (P10 / P90)	% of RORE
Penalty (bills fall, Company income fall)	£3.4m per year	£1.5m per year (£1.90 per customer if all triggered)	1.4%
Reward (bills rise, Company income rises)	£2.4m per year	£1.3m per year £1.60 per customer if all triggered)	1.2%

- Some penalties increased following our Ofwat meeting (e.g. both leakage ODIs)
- Some financial incentives are penalty only.
- In others the rewards exceed the penalties. This may look odd when considered in isolation, but overall the package is one with greater penalties (40% more at maximum level)



Water Quality Compliance (MZC)



Key points:

- 99.97% PC is based on our 5 year average and is stretching compared to industry average of 99.96%.
- We need to allow for natural variability around our PC in our penalty deadband. Typical operating range is expected to be between 99.95% and 100%.
- With this deadband we'd have paid a penalty in 2012/13 when we scored 99.94%.
- Our collar is set at 99.92% which is the level at which we'd expect material regulatory action. This is a best judgement but supported by the Welsh DD which uses the same collar.
- We have calculated our penalty rate using our WtP data on water quality and by estimating our costs of dealing with deteriorating performance. We have used Ofwat's penalty formula.
- We will report to 3dp and apply penalties continuously in our penalty region.

Penalty value

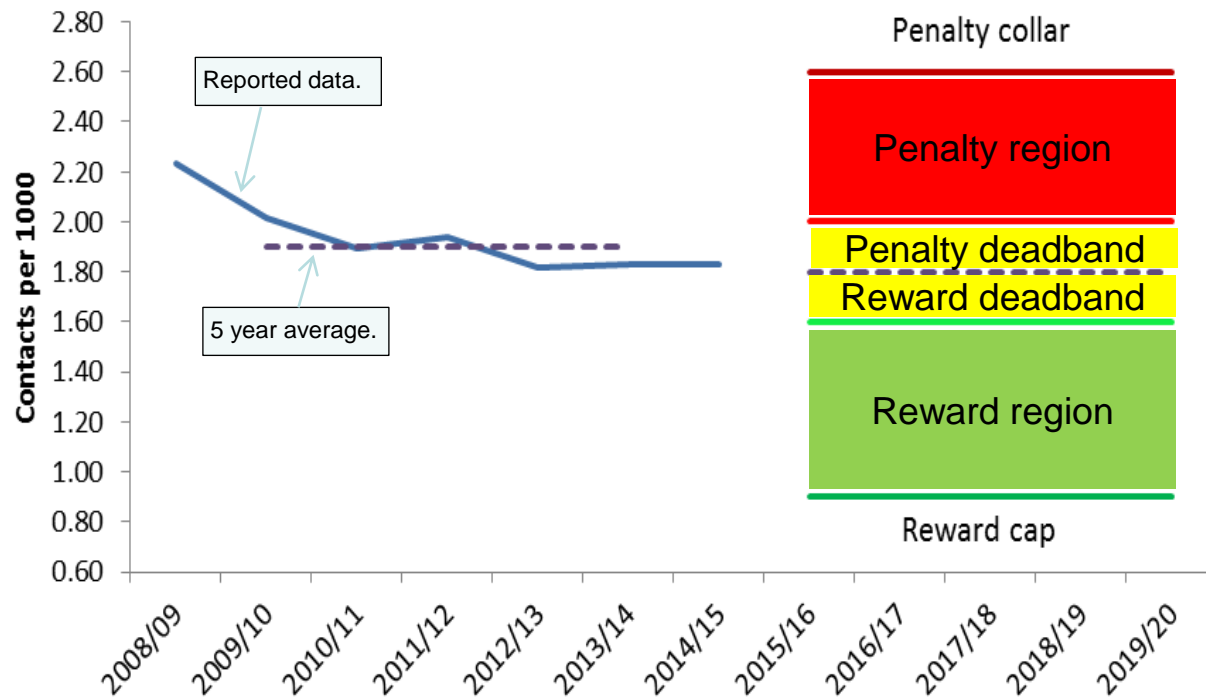
£65k per 0.01%

- P10 is 99.92% based on the value we experienced in the SST region in 2012.



South Staffs Water

Acceptability of Water to customers SSC



Key points:

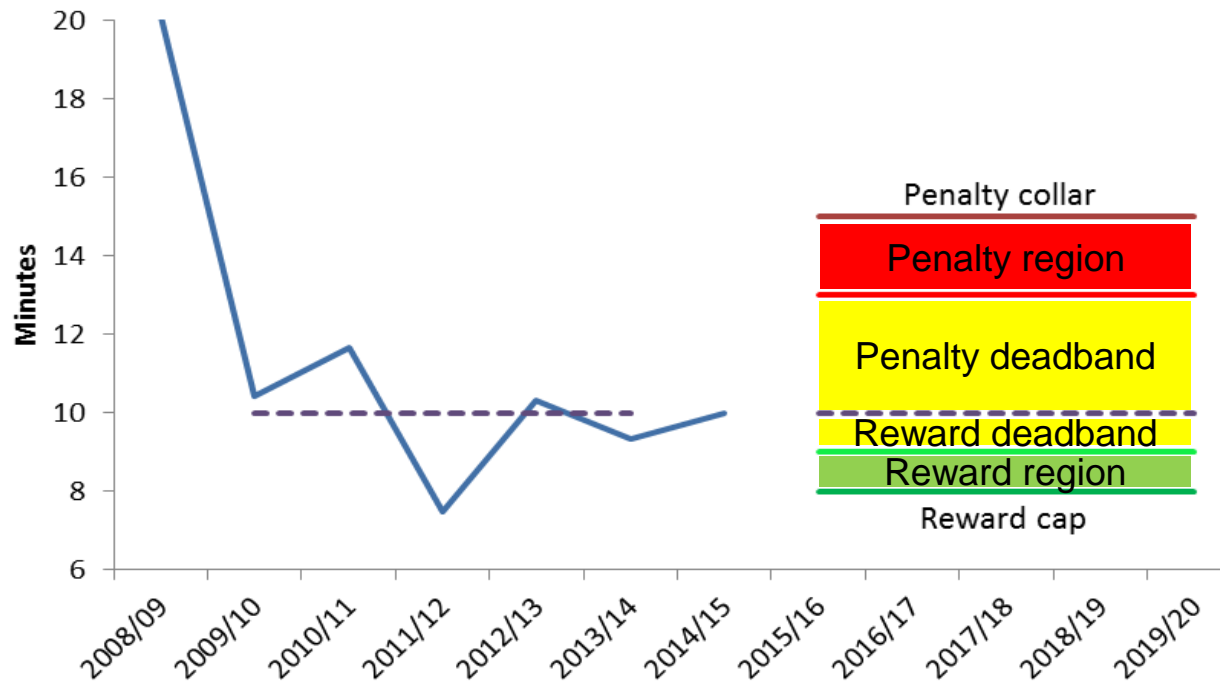
- 1.80 PC is more stretching than our most recent performance of 1.83 or our 5 year average performance of 1.90.
- We need to allow for natural variability around our PC in our penalty deadband. Typical operating range is expected to be between 1.60 and 2.00.
- With this deadband we'd have paid a penalty in 2008/09 and 2009/10.
- Our reward deadband is symmetrical and we'd have earned no rewards with this deadband in our data history.
- Our collar is set at 2.60 which is the level at which we'd expect material regulatory action. This is a best judgement but allows a significant penalty region before the collar cuts it off which safeguards customer interests. Max penalty exceeds max reward.
- Our cap is set at the maximum level we tested in our WtP survey. We have no mandate from customers to extend rewards beyond this level.

Penalty value	£160k per 0.1 nr/1000
Reward value	£123k per 0.1 nr/1000

- We have calculated our penalty rate using our WtP data on water quality and by estimating our costs of dealing with deteriorating performance. We have used Ofwat's penalty formula.
- We will report to 1dp and apply penalties and rewards continuously in our penalty and reward regions.
- P10 is set at the level we experienced in 2008/09.
- P90 is set at a 25% reduction from our PC which is a judgement on what is realistically achievable given investment and focus.



SSC Supply Interruptions



Key points:

- PC of 10 minutes is based on our 5 year average. This is upper quartile in the industry and we want to maintain this.
- We need to allow for natural variability around our PC in our penalty and reward deadbands. A small reward deadband applies because we are upper quartile. We have looked at how a large event could effect us to set our penalty deadband. We have compared these deadbands to Northumbrian's DD and they are consistent.
- With this deadband we'd have paid a penalty in 2008/09 and claimed a reward in 2011/12 which was an unusually good year.
- We have calculated our penalty rate using our WtP data on water quality and by estimating our costs of dealing with deteriorating performance. We have used Ofwat's penalty and reward formulae.

Penalty value	£76k per minute
Reward value	£459k per minute

- Our cap is set at the maximum level we tested in our WtP survey. We have no mandate from customers to extend rewards beyond this level.
- P10 is 14 minutes which represents a 3 minute event being absorbed by the deadband plus a 1 minute event on top.
- P90 is set at 8 mins.
- We will report to 2dp and apply penalties and rewards continuously in our penalty and reward regions.
- Our collar is set at 15 minutes which is the level at which we'd expect material regulatory action. This is a best judgement but allows a significant penalty region before the collar cuts it off which safeguards customer interests.

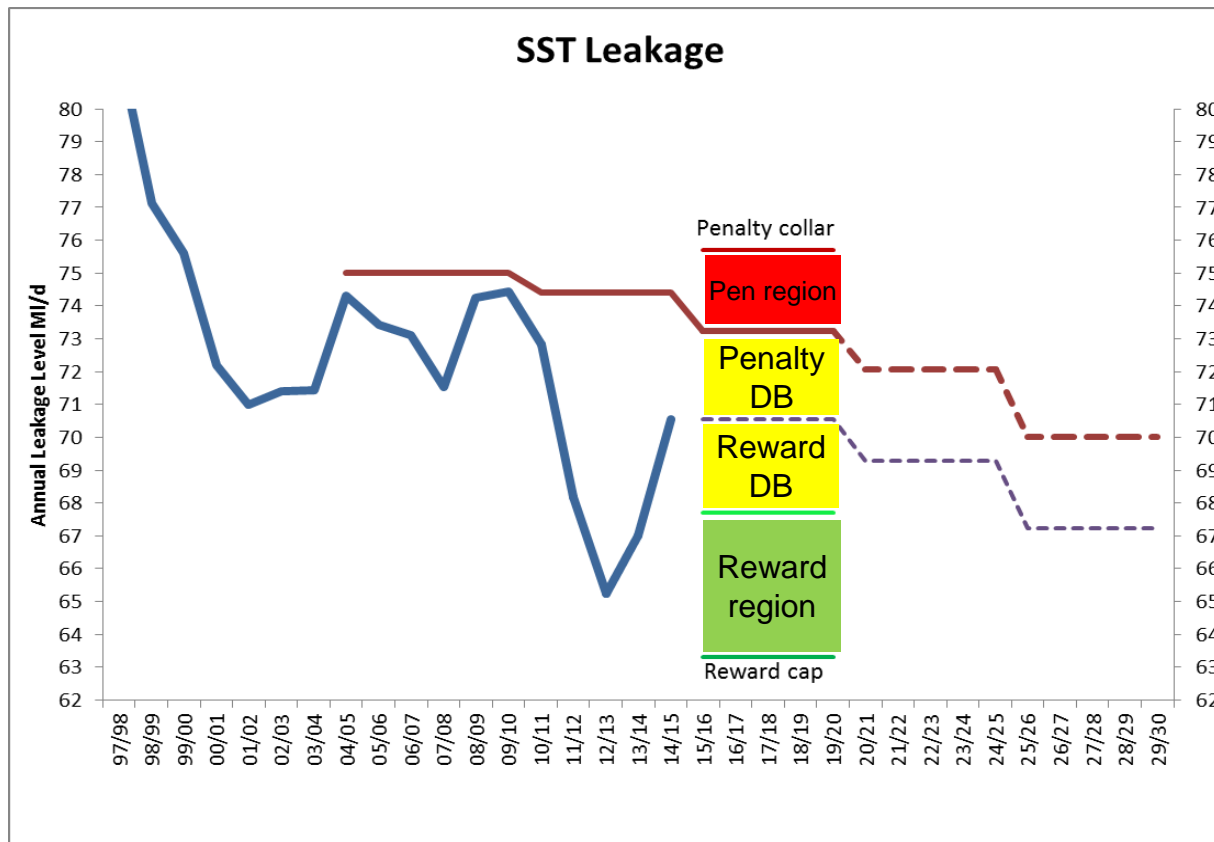


Serviceability Infra and Non-Infra

Key points:

- We commit to maintaining stable serviceability for AMP6 for both sub-services.
- We will use the same serviceability assessment approach as we have used in AMP5 and as Ofwat used before handing it over to companies.
- We have recalculated our serviceability indicator control limits and reference levels for the combined company. We have ensured that the new combined levels are either equivalent or tighter than the AMP5 levels when backcasted for the combined company.
- We have linked our WtP data to our serviceability indicators to calculate the penalty incentive. In the absence of cost data we have applied the full WtP. This is equivalent to using Ofwat's penalty formula with an incremental cost of zero. It will be over estimating our penalty incentive in the customers favour.
- The marginal penalty will apply annually for each year we are in marginal (in practice will be a minimum of 2 years). However if we go to deteriorating this will ramp up to a full penalty which will apply once per AMP.

Infra penalty	£76k per annum for marginal	£379k per AMP for deteriorating
Non-infra penalty	£96k per annum for marginal	£487k per AMP for deteriorating



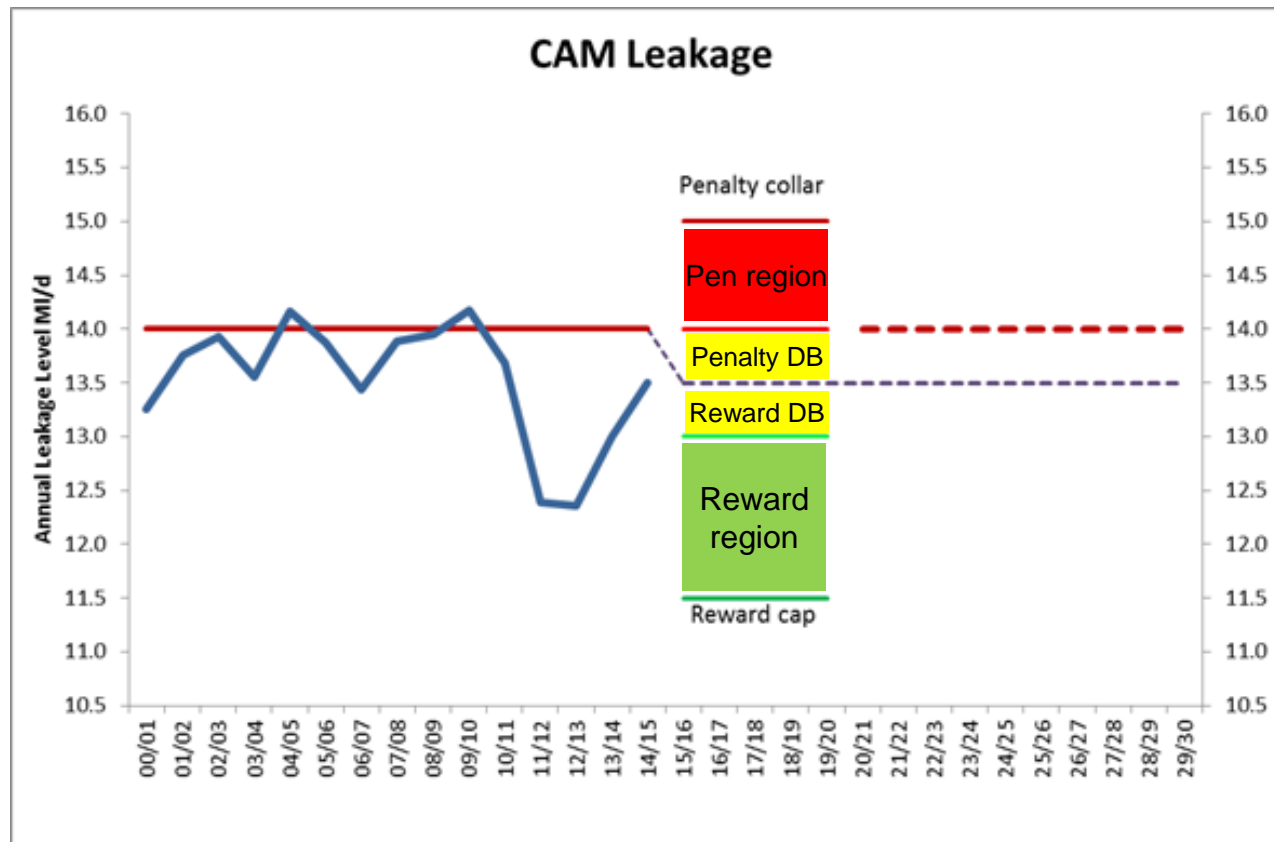
Key points:

- PC of 70.5 MI/d to align with SELL in WRP.
- Penalty deadband to allow for winter weather variability. Our regulatory target has stepped down from AMP5. Reward deadband is symmetrical with penalty deadband.
- With this deadband we'd have paid penalties in 2004/05, 2008/09 and 2009/10 and claimed rewards in 2012/13 and 2013/14.
- Reward cap set at the maximum performance improvement level tested in our WtP survey. We have no mandate from customers to extend rewards beyond this level.
- Regulatory target continues to step down beyond AMP6 due to carbon impacts on the SELL economics.
- We will report to 1dp and apply penalties and rewards continuously in our penalty and reward regions.

Penalty value	£369k per MI/d
Reward value	£186k per MI/d

- For this year we are on target for our 70.5 MI/d forecast.
- We have calculated our penalty and reward rates using our own WtP data on leakage and using our SELL totex model which has been independently audited. We have used Ofwat's penalty and reward formulae.
- P10 set at worst year performance in 2009/10.
- P90 set at best years performance, approx 65 MI/d.
- Max penalty exceeds max reward.





Key points:

- Regulatory target of 14 MI/d still stands but we have set our PC at a more stretching target of 13.5 MI/d. We are already operating below the SELL.
- Penalty deadband between our PC and our regulatory target. We will pay penalties if we breach our regulatory target. Reward deadband is symmetrical with penalty deadband.
- With this deadband we'd have paid a penalties in 2004/05, and 2009/10 and claimed rewards in 2011/12 and 2012/13.
- Reward cap set at the maximum performance improvement level tested in our WtP survey, less the effects of growth in the region over the next 25 years. We have no mandate from customers to extend rewards beyond this level.

Penalty value	£305k per MI/d
Reward value	£154k per MI/d

- P10 set on worst year performance in 2009/10
- P90 set on best performance, approx 12.5 MI/d.
- On a like for like basis a flat projection actually represents a leakage reduction of 3.9 MI/d when growth in the region is taken into account over 25 years.
- Max penalty exceeds max reward.
- We have calculated our penalty and reward rates using our own WtP data on leakage and using our SELL totex model which has been independently audited. We have used Ofwat's penalty and reward formulae.
- For this year we are on target for our 13.5 MI/d forecast.

- We will report to 1dp and apply penalties and rewards continuously in our penalty and reward regions.



Overall Incentive Package based on revisions

- MAX penalty = £3.36m, P10 penalty = £1.52m, 1.4% of RORE
- MAX reward = £2.37m, P90 reward = £1.28m, 1.2% of RORE
- Hence in line with Ofwat range of +/- 1 to 2%

Incentive	Previous Max Value	New Max Value (annual)	New P10/P90 Value (annual)	P10/P90 Per Customer (annual)	P10/P90 % RORE (annual)
PENALTIES					
MZC	£213k	£195k	£195k	£0.28	
AoWtC	£329k	£960k	£384k	£0.55	
Supply interruptions	£308k	£152k	£76k	£0.11	
Serviceability Infra	£207k per AMP	£379k	£152k	£0.22	
Serviceability Non-Inf	£201k per AMP	£487k	£195k	£0.28	
Leakage SST	£353k	£886k	£369k	£0.65 (SST only)	
Leakage CAM	£145k	£305k	£153k	£1.18 (CAM only)	
	£1.76m	£3.36m	£1.52m		1.40%
REWARDS					
AoWtC	£329k	£861k	£246k	£0.35	
Supply interruptions	£616k	£459k	£459k	£0.66	
Leakage SST	£534k	£818k	£502k	£0.88 (SST only)	
Leakage CAM	£219k	£231k	£77k	£0.59 (CAM only)	
	£1.70m	£2.37m	£1.28m		1.18%

*RORE = return on regulatory equity (for SSC this is 35% of RCV of £310m = £108.5m)

Update on Reputational Measures

- Criteria adopted by Board to determine if a measure has financial incentive applied:
 1. Be directly under Company control
 2. Be quantitatively measurable
 3. Be independent of other mechanisms
 4. Be fully supported by all stakeholders and have customer WTP values to allow a reward/penalty
- If this criteria is not met, the measure will be reputational. Here, focus is on reporting of progress and keeping these issues high on our agenda.
- Good progress made with CCG sub-groups which we really appreciate.



Outcome	Reputational Performance Measure	Examples of activities / commitments	Rationale for why reputational
Excellent Customer Experience	Community activity & engagement	400 employee days	Our customers are supportive of these initiatives, but are not will to pay more for them
	Customer satisfaction surveys	98% customer satisfaction (survey will also monitor brand awareness)	Already a financial mechanism existing through SIM (where penalty>reward)
Operations that are Environmentally Sustainable	Biodiversity Activity – now includes Catchment Management	116ha of Company Land managed	Our customers are supportive of these initiatives, but are not will to pay more for them
	Water Efficiency Programme – now includes the measure of Water reuse in Cambridge	PCC of 128 l/h/d (further 3 litres reduction)	No deficit within our WRMP and Defra long term target of 125 /p/d applies
	Power & Carbon usage	Further 5,210 tCO2e saved	Already financial incentives existing, i.e. carbon tax (CRC scheme)
Fair Customer Bills	Independent Customer Surveys	To ascertain views on value for money and affordability	Already a financial mechanism existing through SIM
	Support for Customers in debt	Support those in hardship and therefore number in water debt	Customers are not supportive of our proposals for social tariff nor reinvestment of merger savings

Overall Financial / Future Bill Position

- Ofwat model now used, with some differences to the KPMG model previously used.
- Overall the changes provide slightly greater revenue needs (combination of technicalities, plus high legacy values etc.)
- Current intentions are to adopt a 5 year average bill change of zero thereabouts, consistent with December plan.



Reminder of Milestones in June

- 3rd June: Totex representations made on power costs
 - 9th June: PR09 Legacy submission sent to Ofwat
 - 11th June: Gap analysis submission sent to Ofwat
 - 13th June: CCG meeting
 - 17th June: Ofwat meeting on gap analysis and SCP
 - 26th June: Board meeting
 - 27th June: remainder of updated plan submitted by 9am and the short form CCG supplementary report.
-
- 29 August Draft Determination
 - 2nd October deadline for responses to Ofwat



South Staffs Water Business Plan Acceptability Study Main Study Results

June 2014



South Staffs Water

Contents

- Overview of study
- High level findings for Acceptability
- Next steps
- Conclusions



Overview of the study

- The Acceptability survey completed and results collated
 - This is a test of the revised business plan
 - Aim is to understand how acceptable the plan is
- 1000 surveys conducted with customers:
 - 800 Household
 - 500 South Staffs
 - 300 Cambridge
 - 200 Business Online
 - 100 each region
- Survey modes
 - Household – CAPI and Online
 - Business – CATI and Online

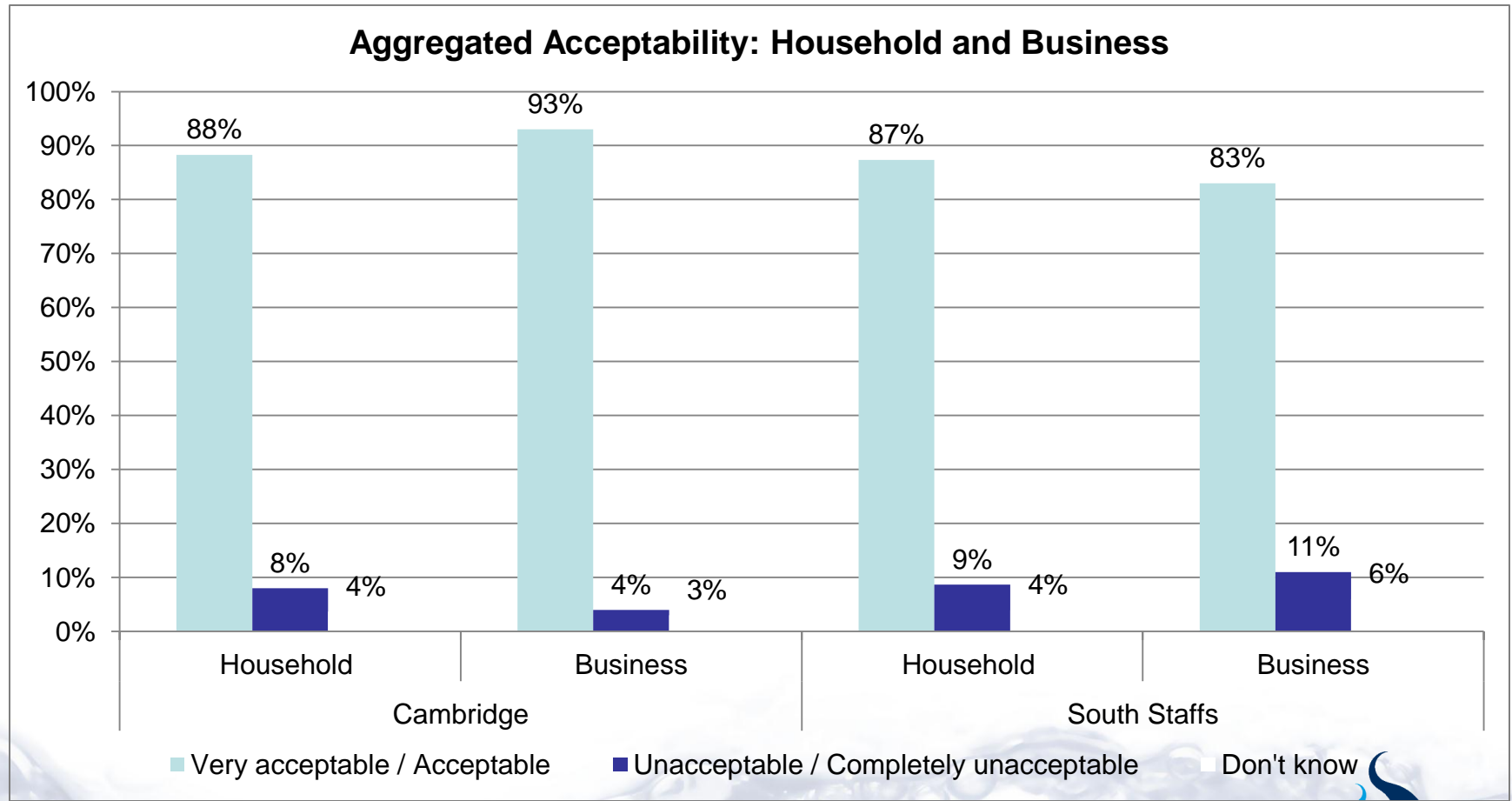


Price Base – Real

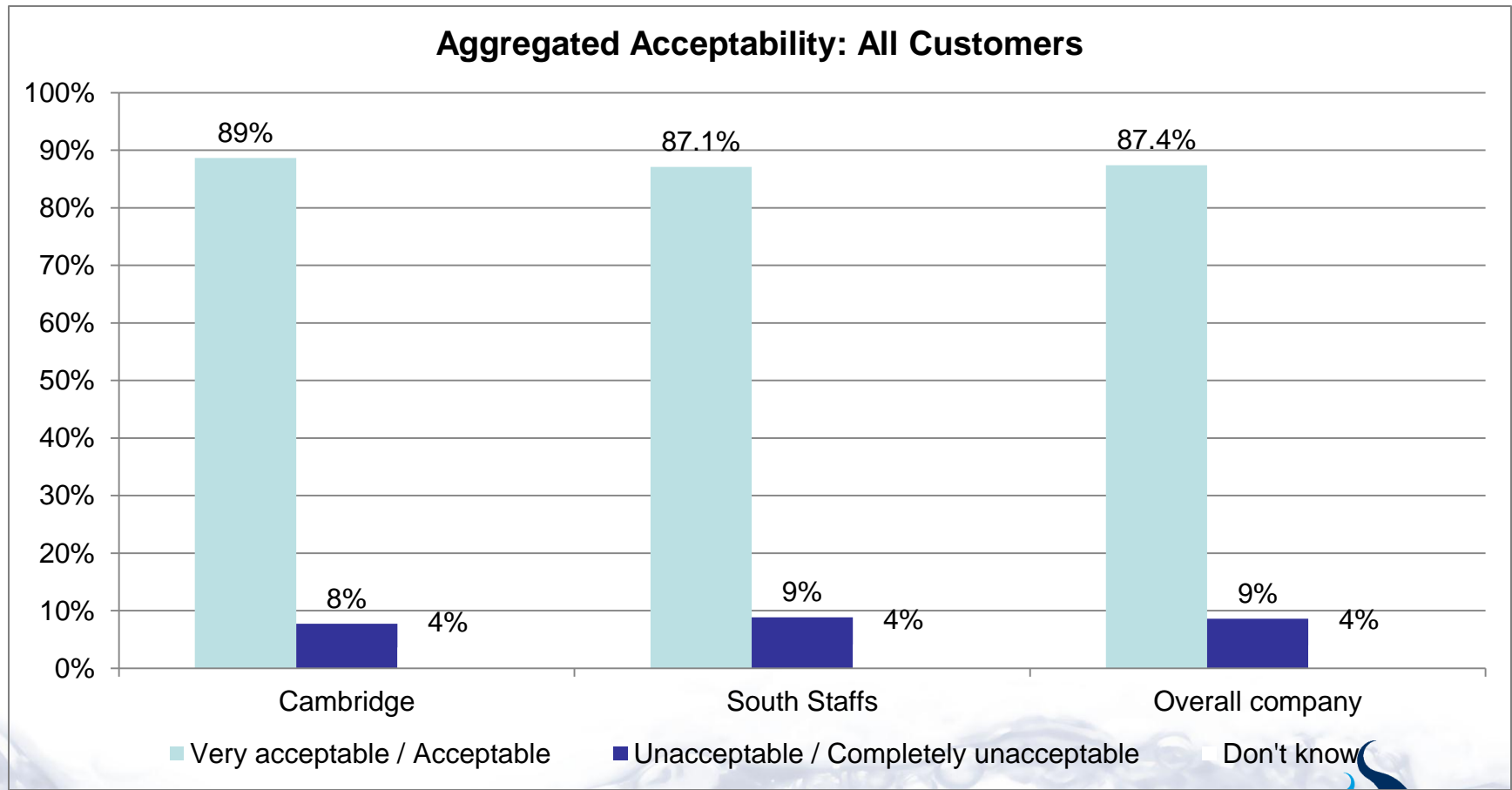
- All prices are shown in real terms
- REAL
 - This involved presenting all figures in real terms to 2020
 - All appropriate references to inflation, including example of the impact inflation has on the bill included
- Aligns with the reported values by Ofwat of the enhanced companies. This approach was agreed after discussions with Ofwat and the CCG.



Acceptability results - split by region and customer type

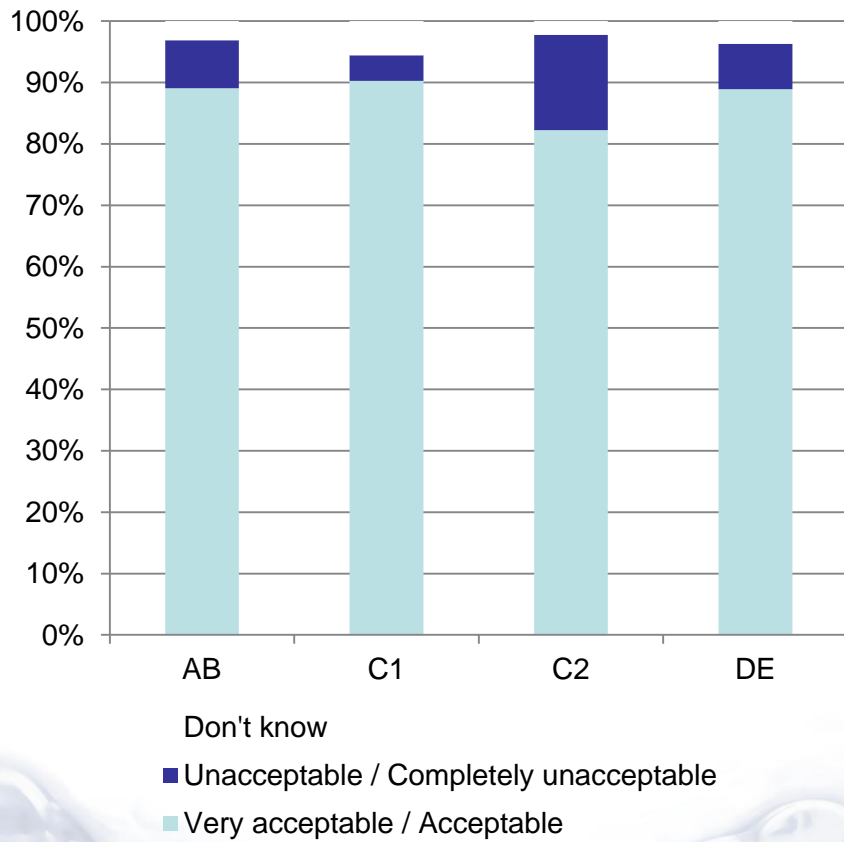


Acceptability results - split by region and overall

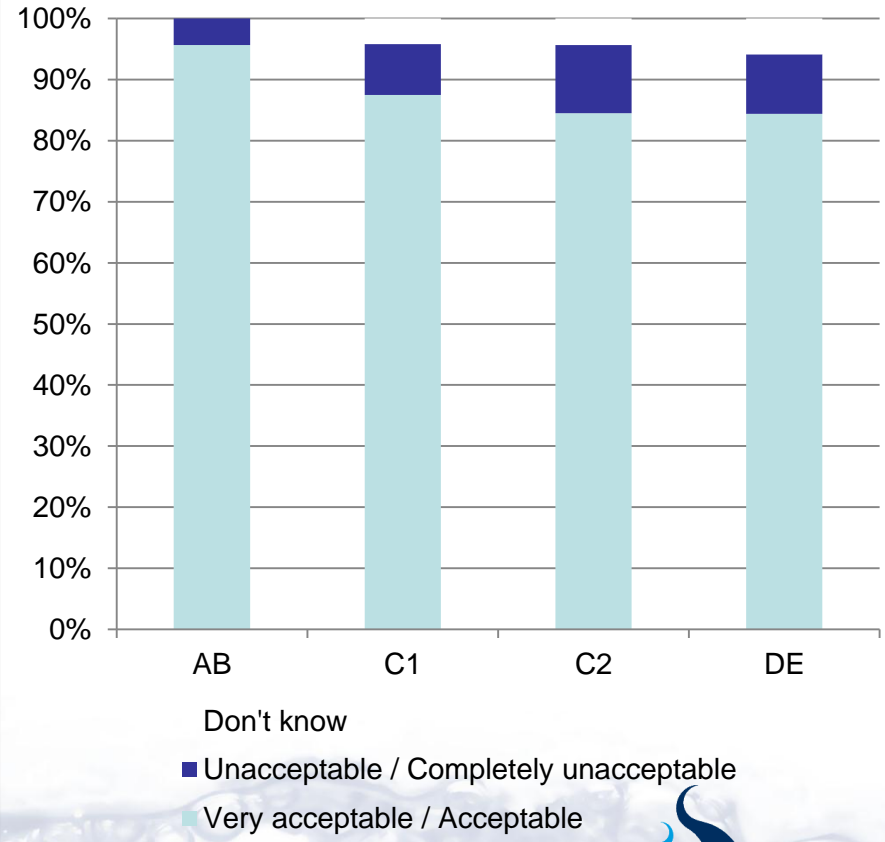


Acceptability by SEG - low SEG find high acceptability

Acceptability by SEG - Cambridge



Acceptability by SEG - South Staffs

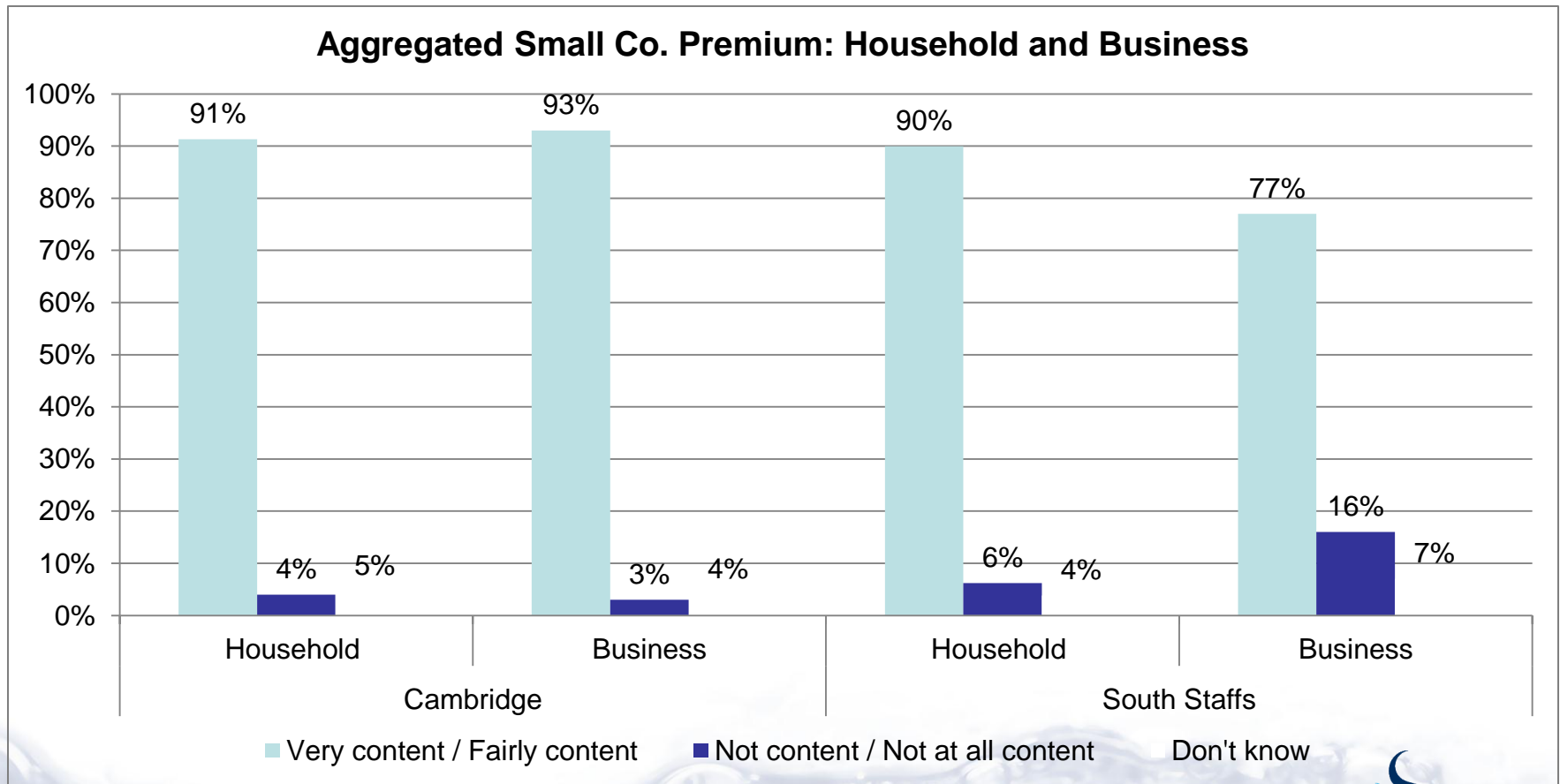


Findings

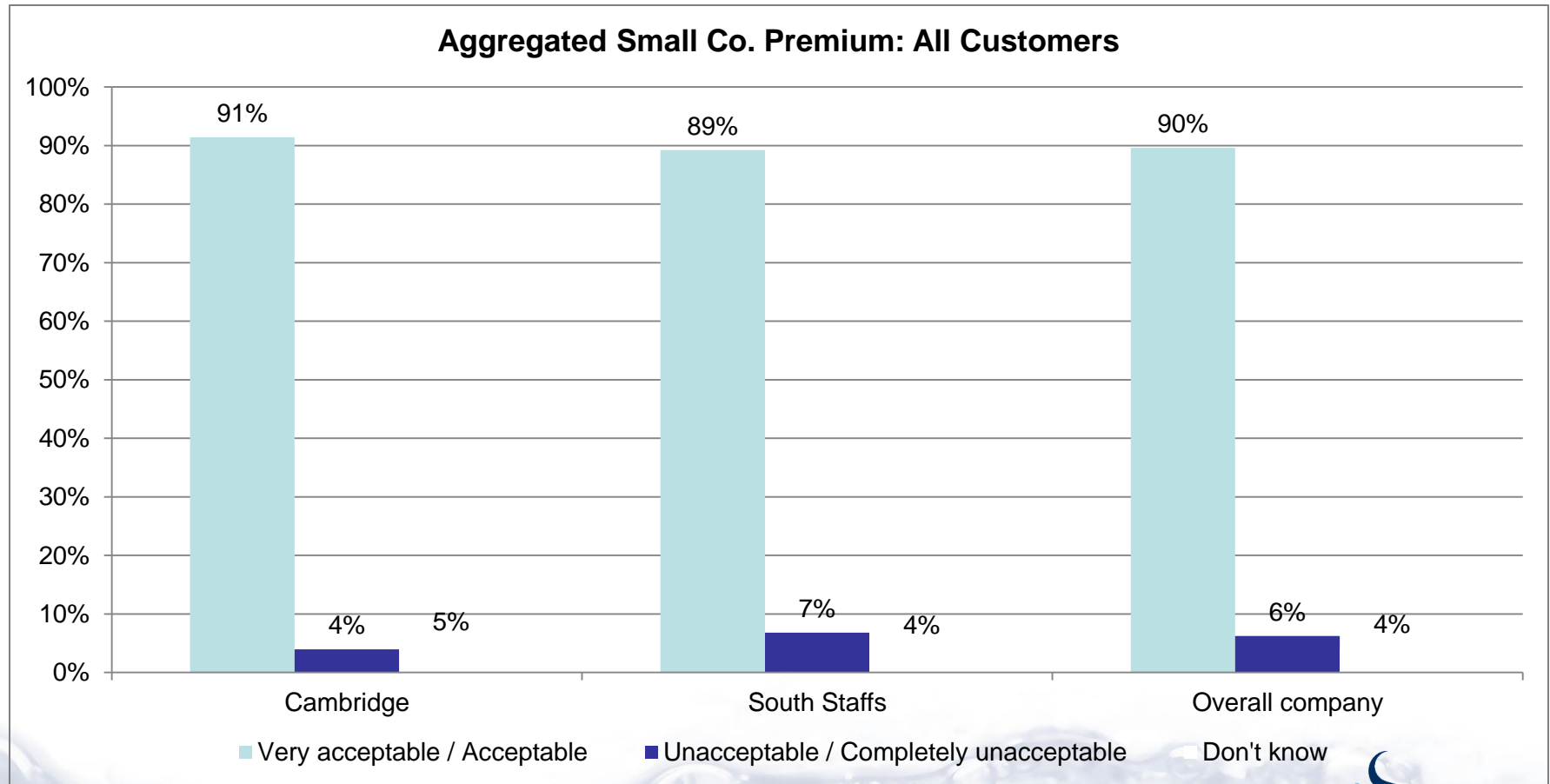
- High levels of acceptability
- Across all regions and customer types
- Results are for a representative sample of customers
- SEG has an impact, but all categories find high levels of acceptability



Small Company Premium – split region & customer



Small company premium - split by region and overall



Summary

- Survey works well with good engagement from customers
- Significant support for the plans evident
- Overall acceptability is high
- Support for local premia also high
- Next steps are to fully analyse the data
 - E.g., Initiatives, full sample information, etc
- Produce reports



Future Assurance, Transparency Auditing and Reporting

