

PORTSMOUTH WATER Ltd
CUSTOMER CHALLENGE GROUP (CCG)
MEETING HELD ON MONDAY 9 JUNE 2014

PRESENT: Charles Burns (FSB), Amy Gallop (Secretary), Karen Gibbs (Consumer Council for Water), David Guest (Independent Chairman), Douglas Hunt (Atkins Independent Reporter), Mike Kirk (Portsmouth Water), Steve Morley (Portsmouth Water), Simon Oakley (Chichester District Council), Kirk Phillips (Winchester City Council), Nick Sheeran (Portsmouth Water) and Neville Smith (Portsmouth Water).

Action

1. Apologies:

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), Richard Harris (West Sussex Hospitals Trust), John Havenhand (Consumer Council for Water), David Howarth (Environment Agency), Derek Kimber (Gosport Borough Council), Douglas Kite (Natural England), Chris Manning (South Downs), Milo Purcell (Drinking Water Inspectorate), Ian Rawson (KWS -Defence) Tim Richings, Jon Stuart (Havant & District Citizens Advice Bureau) and Rob Wood (Portsmouth City Council).

2. Minutes & Actions of Meeting Held on 23 April 2014

The minutes were taken as a correct record subject to a minor name amendment and approved by the CCG.

The Secretary agreed to chase Chris Manning on his outstanding action from the last meeting.

3. Update on Company Plan

Nick Sheeran summarised the proposed resubmission to Ofwat as follows;

- Prices remain flat in real terms 2015-2020
- Accepted Ofwat guidance on industry WACC but included WACC premium of 0.5%
- Board have decided to give up £5m of legacy items to keep bills flat
- Ofwat concerns on willingness to pay and performance commitment being addressed
- Included financial incentives for water quality measures
- No change to TOTEX
- Plan is financeable if a WACC premium is allowed

Nick Sheeran circulated two brief reports. One explaining the benefits to customers from being served by Portsmouth Water (the Company) and why the WACC premium of 0.5% is justified; the other showing the impact on financeability of including or excluding WACC premium.

Kirk Phillips raised concern that Ofwat previously advised that they would not allow the Company to include a Small Company Premium in this Plan and questioned whether the Company had confidence that it would be accepted. Nick Sheeran confirmed that the Company had been in discussions with Ofwat and in order to be allowed a small company premium, the Company must show that there are benefits to customers which offset the cost to them of the

premium.

Nick Sheeran advised that following work undertaken by Frontier Economics the Company will be supporting their request for a Small Company Premium with the following justification;

- The Company is one of the most efficient companies according to data from Ofwat, ranking second in most of the Models used by Ofwat. These models are used to set benchmarks for the Industry. Without the Company, the benchmark would be higher, with costs across the industry being £84m higher, over five years. This equates to approximately 51p for households in the country.
- The Company has one of the lowest Capital Value (Asset Base) per customer in the industry. Even with a premium on its WACC, the absolute return per customer is far lower than any other company in the country. Frontier estimates that the benefit is worth £45m over five years or £31 per customer.
- As noted above, the Company is one of the most efficient companies in the industry. Compared to the average company, its customers benefit to the value of £8.5m over five years or £5.80 per customer.

Nick Sheeran further advised that Ofwat suggested the Company complete further Customer Research asking Customers if they value a small local Company. He confirmed that MVA have been invited to carry out a Survey by the end of June.

David Guest questioned what would happen if the Survey Results did not support the Company's view that Customers value a small local Company?

Nick Sheeran commented that the Company would then not be in a position to justify the Small Company Premium

Neville Smith added that then the Company would then know the Customers view and would decide instead not to give up as much Legacy. He also advised that other Company's have been completing this research and finding that Customers do value a small local Company.

Neville Smith advised that if Ofwat do not allow the Small Company Premium the Company could dispute this decision and take it to the Competition Commission. History shows that there is a precedent set at the Competition Commission which would allow a Small Company Premium.

David Guest questioned if the Small Company Premium is disallowed could the Company balance with the amount of Legacy it gave up?

Nick Sheeran confirmed that yes the Company could. However, this impacts on the long term financibility of the business. He advised that in this scenario the ratios for the first five years would allow the Company to maintain its credit rating, but they are not adequate for the second five years and the credit rating would be at risk. He further advised that the Small Company Premium makes the Company financeable in AMP6 and AMP7 but Legacy Items fall away after AMP6 and the Company is then not financeable.

Neville Smith commented that the Company feels Customers have benefited from reduced bills over the last ten years as a result of the Company's approach.

Karen Gibbs reminded the CCG of their role to ensure the Company consults with its Customers and therefore should support their decision to complete this further Customer Survey. However, she doubted whether Quantitative research was the correct way to go, she suggested Qualitative research.

John Hall questioned if other Company's claim the Small Company Premium?

Neville Smith confirmed that all small Water Only Company's previously received the Small Company Premium and will be including it in their Plans this time.

Karen Gibbs commented that the Company has a very persuasive case for a Small Company Premium based on the evidence provided and the results of the Survey should be used to further justify.

Simon Oakley raised that the conclusions from the Frontier Economics work were slightly inconsistent in the way the information was reported e.g. 'This equates to approximately 51p for households in the country' and 'its customers benefit to the value of £8.5m over five years or £5.80 per customer'. He suggested when completing the further Customer Research the Company should state either per household or per customer figures to keep it consistent.

Post Meeting Note: Accent was appointed to undertake qualitative research.

4. Presentation on Rewards and Penalties

Steve Morley circulated papers to the CCG detailing how the Company chose its Outcomes and Performance Commitments and how the Willingness to Pay findings had been used to prioritise areas of activity to ensure the Company delivers the outcomes customers expect.

Steve Morley took the CCG through a table highlighting the proposed changes to the Company's Outcomes, Performance Commitments and Outcome Delivery Incentives since the December Plan.

He asked the CCG to consider the proposals and question the following;

1. Are the targets / Outcomes consistent with the Customer Research?
2. Are the targets / Outcomes set appropriate and / or stretching?
3. Should the Incentives be financially driven or impact on reputation?

He advised that the Company's incentives were predominantly reputational compared with Affinity's Plan, that received Enhanced Status, which was mainly financial rewards.

A paper was circulated detailing the Company's rationale to apply financial or reputational incentives. Steve Morley commented that the Board did not feel that it needed a financial incentive to do the right thing. He noted that there was also strong customer dissatisfaction with the concept of rewards for companies merely doing what they should be doing that was found in recent CCW research.

Kirk Phillips questioned whether reputation matters when a Customer cannot chose to change to a different supplier.

Neville Smith commented that he feels reputation drives behaviour more than penalties and the Company has a strong desire to be good performer.

Steve Morley said staff look at league tables and can be a morale booster when performing well.

Mike Kirk commented that the Board look at the reputational areas of the business before the financials at every Board meeting.

John Hall illustrated the need for the Company to understand the impact of their performance on Customers.

Steve Morley circulated a further paper quantifying Penalties / Rewards associated with the Outcomes.

David Guest suggested having Water Efficiency Targets on Customers Bills and show what their daily consumption is compared to the target.

Steve Morley agreed this was a good idea as the whole process is about communication and education for the Company's customers.

Steve Morley advised that he was seeing Ofwat on 11 June to discuss this issue further.

5. Discussion on Ofwat Workshops

Karen Gibbs confirmed that she had circulated her notes on the last Southern CCG Chairs Workshop ahead of the meeting for information.

David Guest advised that the next Southern CCG Chairs Workshop would be held on 10 June 2014 and he would discuss with the other Chairs how other Companies have looked at the Financial v Reputational balance on their incentives and how Affinity's Plan was so successful.

6. Future role of the CCG

Nick Sheeran advised that the Company welcomed the development of the Customer Challenge Group as part of this Business Planning process. He reminded the CCG of their involvement in the development of the Plan and in particular establishing the Performance Commitments and Outcome Delivery Incentives.

The Company proposes for the CCG to have a role in reviewing the performance against each of the commitments and understanding how the Board has established if in particular rewards or penalties should apply.

The Company intends to continue meeting with the CCG throughout AMP6 and will present its Annual Risk & Compliance Statement to the CCG in particular for them to review and challenge.

David Guest questioned how the CCG in their capacity could challenge the data provided in the Risk & Compliance Statement.

Doug Hunt advised that the data itself is already subject to an independent technical challenge and assurance by the Reporter, and it would be difficult for the CCG to be able to add much comment about data quality. However there is a role for the CCG to challenge reasons for any slippage, or operational changes that have been made to achieve out-performance, or how improvements have been made during the year.

7. Timeline for remainder of 2014

Steve Morley advised the CCG of the key dates for the rest of the year as follows;

27 June	Resubmit Plan
29 August	Ofwat Publish Draft Determination
10 September	CCG Meeting
3 October	Submit Representation on the Plan
12 December	Ofwat Publish Final Determination

8. Private Session

Kirk Phillips suggested that a Private Session should be held first on the agenda of each CCG meeting so that members can collect their thoughts before entering discussions with the Company.

David Guest and the Company were in agreement to structure future meetings this way.

9. Any Other Business

There was no other business.