

# Water companies' use of customer engagement in their PR19 redetermination statements to the CMA

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## **An independent report for Citizens Advice**

This report is a 'rapid review' of the use of engagement arguments by Anglian Water, Yorkshire Water, Northumbrian Water and Bristol Water in their initial Statement of Cases to the CMA. It is intended to inform Citizens Advice's submission to the CMA.

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## EXECUTIVE SUMMARY

Four water companies have appealed to the Competition and Markets Authority (CMA) for a redetermination following Ofwat's 2019 price review (PR19) – Anglian Water (AW), Yorkshire Water (YW), Northumbrian Water (NWL) and Bristol Water (BW).

This paper has been drafted by Sustainability First to inform Citizens Advice's response to the CMA on the companies' appeals. It is based on a 'rapid review' of a limited number of documents in the public domain and interviews with the Chairs of three of the four relevant Customer Challenge Groups. It does not give views on the companies' efficiency arguments, that is a matter for the CMA. The scope of this paper is limited to how the appealing companies use customer engagement in their initial Statement of Cases. It is not a comprehensive analysis but synthesises key documents with suggestions of areas for further scrutiny and recommendations for the CMA, Ofwat and consumer bodies.

### Use of engagement arguments by companies in their Statement of Case

- To varying degrees all four appealing water companies argue that Ofwat has ignored, misinterpreted or has given insufficient weight to consumer views in making its final determinations.
- The companies quote insights from a wide range of qualitative and in particular quantitative research – much of which appears to follow good practice and is recognised as high-quality by Ofwat, their respective Customer Challenge Groups (CCGs) and the Consumer Council for Water (CCW).
- All four companies believe that customer views have not been appropriately considered by Ofwat in developing some outcome delivery incentives.
- Three of the four companies (excludes Bristol Water) say that as result of Ofwat's proposed funding settlement they will not be able to deliver the outcomes that customers want. In particular that the final determination will impact resilience; that Ofwat's focus on short-term bill reductions will result in intergenerational unfairness, with future customers paying more and higher costs overall. Also, that customers desire flat stable bills which the companies imply the determinations will not deliver.

### Companies' use of cost of capital and fair returns customer insight

- The appealing companies challenge Ofwat's proposed cost of capital and express concerns about the allowed level of company returns, which three of the four companies (excludes Bristol Water) say will impact their ability to deliver the outcomes that their customers want.
- We found no evidence that companies had *cited* customer insights on profit levels or the cost of capital to support their arguments in this area. No company appears to have engaged *robustly* on what customers see as a fair return and this seems to be a gap.
- However, in line with Ofwat's PR19 methodology, companies have conducted engagement on rewards and penalties (which form part of overall returns) and this is used to varying degrees in the calculation of outcome delivery incentives (ODIs). In addition, all companies have undertaken consumer engagement on wider financing issues and this research may be worth further investigation.

## The validity of engagement arguments

- In a number of cases the regulator says it has not ignored the views of customers, but thinks that the same outcome that consumers want can be delivered for less. In these instances the argument would seem more about company efficiency rather than engagement and the two things should not be confused.
- It is reasonable to assume that customers would not want to pay for inefficient costs. In this regard, (if Ofwat's assessments are correct), the regulator would be acting in accordance with Ofwat's Engagement Principle 7 outlined in its PR19 methodology - stepping in to protect consumers. Indeed qualitative insight from the companies' insight synthesis reports and wider research indicates that many customers are concerned about: unfair prices and money going unnecessarily into shareholder pockets; do not feel qualified to make decisions on efficiency; and expect Ofwat to perform this role - thus highlighting its importance.
- In at least one important instance, Ofwat appears to challenge the *need* for a proposal (NWL's Abberton-Hanningfield raw water transfer scheme in Essex) rather than customer support for it. Though it is unclear if customers would support it if they didn't think it needed. However, NWL thinks the strength of consumer views towards longer-term resilience investment is not reflected in the regulator's overall assessment of need. Understanding how Ofwat has weighted consumer and societal value in its assessments of 'need' would be useful.
- Ofwat says it "did override" customer research in some cases. This is for three main reasons: to better align the decision with customer interests and preferences; as it thought the research that underpinned the company's decision was poor quality; or as it had additional evidence that was not available to the company's stakeholders including the CCG. Also, that ultimately decisions are the product of 'regulatory discretion'. We would encourage the CMA to ensure transparency around the methodologies, values, assumptions and trade-offs informing decisions. This is especially the case as Ofwat's approach has arguably not been subject to the same level of scrutiny as the companies.
- Company proposals that have been co-created with customers and communities; local schemes where views may be strongly held; resilience approaches where it is necessary to balance the needs of current and future generations; and Ofwat's approach to regional variations in customer views, are all especially sensitive and warrant particular focus by the CMA.

## Assessing the value of engagement evidence

A key challenge for the CMA is understanding the robustness of engagement and then what weight to place on customer and stakeholder views in its price review decision.

- Assessing the quality of engagement is notoriously difficult and the weighting of specific customer insights is made more challenging by the lack of consensus and transparency across the water sector as to what good practice really looks like.
- The three key sources of evidence available to the CMA: Ofwat's own engagement assessments; customer challenge group views; and CCW's assessments and research, with some noted exceptions, all state that the overall quality of all four companies' engagement is good. But assessments are not without limitations which we outline in this report and encourage the CMA to take into consideration. For example, there is significant variation in the breadth and depth of different CCG's scrutiny, the expertise on their groups (especially on willingness to pay and wider evaluation techniques), and the quality of governance arrangements and reporting, which may influence the weight the CMA wants to give to their respective views.
- The pros and cons of different research approaches and the limitations of any engagement programme are well-rehearsed. As a general rule, while the quality of individual research

will vary across companies, this review suggested that it is easier to engage customers and stakeholders on outcomes, preferences, priorities and bespoke performance commitments.

- A more cautious approach may be needed regarding insights on individual outcome delivery incentives (which make up a proportion of company overall returns) - especially attitudes to rewards and penalties, caps/collars in particular. Also, engagement conducted in response to the Initial Assessment of Plans due to the regulatory time constraints imposed. It is also well recognised that customers struggle to engage with probabilities/risk appetite, and technical concepts such as 'voids' and 'gap sites'.
- The appealing companies operate in different contexts and have different challenges, performance histories, and relationships with their customers with some more trusted than others. It may be harder to have confidence in regional variations of views between companies due to the lack of comparable research, but it is still important to explain how these have been taken into consideration.
- Qualitative research can provide useful insight into the values and assumptions that are driving consumer views and understanding values may be increasingly important given the Covid-19 pandemic and rapidly changing context.
- The companies cite high acceptability for their original business plans, and Ofwat cites CCW's research which suggests its final determination would also have high customer acceptability. Both are useful 'sense tests' with the public. It is reasonable to assume that had customers thought companies were proposing a higher than needed bill (as Ofwat suggests) that their willingness to pay, acceptability levels, and sense of affordability (which is often linked to perceptions of value for money) of the plan would have declined

## RECOMMENDATIONS

### Recommendations for the CMA

1. There is a general consensus that customer engagement has significantly shaped all four companies' business plans, making them better aligned to customer and stakeholder views. We'd encourage the CMA to be mindful of: the outcomes consumers say they want; their values; and preferences for proposals and bespoke performance commitments, in making its final determination.
2. The CMA may want to particularly explore how certain Ofwat 'discretionary' decisions have been made. Greater transparency around the values, assumptions, methodologies and wider approaches informing any evaluations would be useful. In particular: how Ofwat has defined and valued consumer and societal needs and preferences; how the requirements of current and future consumers have been balanced; and regional variations in views.
3. Given stakeholder concerns about the weighting of consumer views in regulatory decisions, the CMA may want to explore using alternative evaluation methodologies such as Social Return on Investment approaches, or wellbeing analysis as is outlined in the updated Treasury Green book, to ensure the wider public interest is captured.
4. The CMA may want to be particularly mindful of the views of customers and stakeholders where the company has genuinely co-created an approach and worked collaboratively with the community to develop solutions; as this could impact on trust and legitimacy of water companies and regulators. This may be especially the case for local schemes, where engagement could have been extensive, sensitive, and public views strongly held.

5. The CMA is encouraged to explain for each company business plan how it has considered customer and stakeholder views and to provide a clear line of sight between the outcomes customers say they want and the final determination. Greater transparency in this area would be welcome. This will be important for trust and legitimacy.
6. Customers want to have confidence that prices are fair and based on efficient costs but we urge the CMA to provide assurances that a focus on bill reductions is not at the expense of broader outcomes that consumers value.
7. The majority of insight that underpins company business plans was carried out prior to the Covid-19 pandemic. Consumer attitudes towards affordability and willingness to pay, risk, the environment and resilience may have changed substantially since then. We'd encourage the CMA and Ofwat to review emerging insight and consider conducting its own research in the medium term. While we acknowledge the challenges and implications, we would query the legitimacy of a business plan determination that is made in isolation of this significantly changed context. This could include reflecting on the need for more adaptive regulation in a changing world.

#### Recommendations for Ofwat, Citizens Advice and CCW

8. In line with regulatory good practice we would encourage Ofwat to publish its *full* criteria and assessment for the engagement test area used in its initial assessment of plans so as to provide greater transparency, understanding and confidence in the results. This will help to inform future engagement practice.
9. It is clear that many customers (though not all) are interested in profit levels, dividends and executive remuneration. If this research is conducted, it would be best organised centrally by an independent party to ensure comparability of results, impartiality and cost efficiency. If there is sufficient time the CMA might consider this to inform its decision. More generally, regulators, Citizens Advice or CCW could consider leading engagement in this area to inform price control decisions, including deliberative research to help build understanding and trust in decisions.
10. We support Ofwat undertaking a strategic review of its approach to engagement including: asking what problem engagement is there to solve; what 'opportunities' engagement can help unlock; the respective roles of regulatory-led, provider-led and other engagement activity; and what the future role of CCGs might be within this broader picture. There are clearly lessons learned for all parties – Ofwat, companies and the CCGs. It will be important for the regulator to build on the success of the approach and not 'throw the baby out with the bathwater' given differences of views between the CCGs and the regulator.

## BACKGROUND TO THIS PAPER

In its response to water companies' price determination Statement of Cases to the CMA, Citizens Advice has highlighted that it is "concerned that some of the appealing water companies are misrepresenting consumer evidence to claim that consumer interests would be best served by setting higher prices for a better level of service<sup>1</sup>." In particular that "several water companies have portrayed the impact of Ofwat's determinations as delivering less investment and so leading to different outcomes for consumers"<sup>2</sup>.

Citizens Advice does not think that Ofwat's decisions will impede investment or risk quality of service. Nor does it believe that consumers would "choose to continue paying over the odds for their water services when networks can still pursue their most efficient strategy for long term sustainability"<sup>3</sup>. CitA's understanding is that customers are happy to spend more on services where this improves quality but that companies have not engaged with consumers in a way that helps them to evaluate the implications of capital costs and fair rate of return and are conflating this area with sustainable investment arguments.

To test this assumption CitA commissioned Sustainability First to conduct rapid high-level independent review, over the course of a week, of a selection of information in the public domain to:

- Assess how the four companies that have appealed are using engagement in their submissions, and if they are conflating wider willingness to pay (WTP) and acceptability research insights with cost of capital and efficiency arguments.
- Better understand what engagement or research water companies who have appealed to the CMA undertook on cost of capital/rates of return, if any.
- Provide any resulting insights including as to the quality of research cited and claims made where possible.

The information reviewed is included in Appendix 1: Bibliography at the end of this report. In addition, Sustainability First spoke to the following customer challenge group chairs: Jeff Halliwell (Anglian Water Customer Engagement Forum); Andrea Cook OBE (Yorkshire Forum for Water Customers); Jim Dixon and Melanie Laws (former and current Chair for the Northumbrian, and Essex and Suffolk Water Forums, known as 'The Forums'). Peaches Golding OBE, Chair of Bristol Water Challenge Panel was not available for comment in the short timeframe within which this review was undertaken but fed back comments on this paper which have been included.

### Please note

This summary paper has been drafted by Sustainability First to help inform Citizens Advice's response to the CMA. We do not give views on the companies' efficiency arguments, that is a matter for the CMA. The scope of this paper is limited to how the four appealing companies use customer engagement in their Statement of Cases. This report is in no way an assessment of the quality of engagement undertaken by the four appealing water companies (this would not be possible in the time available), nor is it intended to be a comprehensive analysis. It is a rapid synthesis of a selection of material in the public domain undertaken over one week. We are mindful that significant amounts of further evidence may be relevant which has not been part of this review and consequently this report should be read with that context in mind.

<sup>1</sup>[https://assets.publishing.service.gov.uk/media/5ebbbe1d3bf7f5d364bfc20/Citizens\\_Advice\\_submission.pdf](https://assets.publishing.service.gov.uk/media/5ebbbe1d3bf7f5d364bfc20/Citizens_Advice_submission.pdf) P.2 Point 4

<sup>2</sup> Ibid. p.13

<sup>3</sup> Ibid. p.13

## ABOUT SUSTAINABILITY FIRST

Sustainability First is a think tank and charity that promotes practical, sustainable solutions to improve environmental, economic and social wellbeing. We are a trusted convenor on public utility issues and have a strong track record of bringing stakeholders together in multi-party projects in the public interest. For more information: <https://www.sustainabilityfirst.org.uk/>

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## INTRODUCTION

Four water companies have appealed to the Competition and Markets Authority (CMA) for a redetermination of Ofwat's 2019 price review – Anglian Water, Yorkshire Water, Northumbrian Water and Bristol Water.

Part 1: The first part of this paper provides a synthesis of the main engagement arguments put forward by the appealing water companies in their initial Statement of Cases followed by responses to their arguments from Ofwat, and views from each company's customer challenge group (CCG) and the statutory consumer watchdog CCW. This synthesis is based on a 'rapid review' of a selection of relevant documents outlined in the bibliography. It is not intended to be a comprehensive assessment.

Part 2: The second part of this paper provides some reflections on assessing the value of companies' consumer engagement and includes suggestions for areas for further scrutiny and recommendations to the CMA, Ofwat and consumer bodies.

# PART 1: ENGAGEMENT ARGUMENTS IN WATER COMPANIES' STATEMENT OF CASES TO THE CMA

## Companies engagement related arguments

### Overview

To varying degrees in their Statement of Cases, all four companies argue that Ofwat has ignored, misinterpreted or has given insufficient weight to customer views in making its final determinations (FDs).

They quote insights from a wide range of qualitative and in particular quantitative research, much of which they say follows good practice and is recognised as high-quality by Ofwat in its initial assessment of plan (IAP), their respective customer challenge groups (CCGs) and the statutory watchdog for water consumers, CCW.

All four companies, to different extents, believe that customer views have not been appropriately considered in developing some of their outcome delivery incentives.

Three of the four (Anglian Water, NWL and Yorkshire Water) argue that as a result of Ofwat's proposed funding settlement they will not be able to deliver the outcomes that customers want. They say this will particularly impact resilience proposals; that Ofwat's focus on short-term bill reductions will result in intergenerational unfairness, with future customers paying more and higher costs overall. Also, that customers desire flat stable bills which some companies imply the determinations will not deliver.

In addition, some companies argue that by ignoring customer preferences, Ofwat has failed to satisfy its duty in relation to its regulatory consumer objective. Furthermore, that the regulator has not 'walked the talk' on customer engagement in developing its PR19 methodology nor complied with its own methodology on engagement.

Yorkshire Water says this means regional variations in relation to customer preference and risk, for example linked to river flooding, are not reflected in Ofwat's decision making, and Bristol Water asserts that Ofwat has not reflected the value that customers put on being served by a local company when considering its case for a Small Company Premium. Northumbrian Water argues that two key schemes which customers support, the Abberton to Hanningfield transfer main and one to tackle sewer flooding risk reduction in the North East, will not go ahead.

### Key engagement arguments by company

The following is a summary of key engagement related arguments cited by each company in its Statement of Case:

#### Anglian Water (AW)

- Says its business plan was “co-created with customers” through “the company’s most detailed and extensive process of engagement yet” collating “more than 500,000 customers’ views through more than 30 different channels”. That the high-quality of its engagement is reflected in the views of its independent customer forum and the fact that it was the only water company to be A-rated for its engagement in Ofwat’s initial assessment of plans.<sup>4</sup>
- Argues it proposes to deliver the outcomes that customers value at less than they were willing to pay (WTP)<sup>5</sup>.
- Highlights that customers “overwhelmingly opted in favour of the company being funded to invest now for better and more resilient services and improved environmental outcomes rather than seeing such investment postponed and bills fall<sup>6</sup>” but that the FD “prioritises large short-term bill reductions which will force Anglian to cut back on asset maintenance activity, undertake short-term fixes, and delay service, resilience and environmental improvements”. This will result in future customers paying disproportionately more and higher costs overall<sup>7</sup>.
- Flags that “the majority” of customers found its plan acceptable (94% informed customers) and affordable (87% informed customers).<sup>8</sup>
- Overall believes Ofwat’s final determination (FD) fails to deliver best value for customers compared to Anglian’s Plan, “a point customers recognised when presented with the option of Anglian’s Plan versus Ofwat’s Draft Determination (DD) (which has not changed significantly at FD) and two thirds preferred Anglian’s Plan.<sup>9</sup>”
- Says that the “consequence of Ofwat’s approach to the FD is that Anglian is not financeable”. That “almost every aspect of Ofwat’s FD falls short of providing Anglian with the means to carry out the work necessary to meet the stated preferences of its customers”<sup>10</sup>.
- Suggests that its customer engagement influenced not just the outcome they proposed in their business plan but their approaches to delivering it (*how they do it*) citing leakage as an example<sup>11</sup>.
- Argues that Ofwat’s outcome delivery incentive (ODI) package also “ignores customers views<sup>12</sup>”.
- Overall Ofwat is “disregarding the preferences which the Company’s customers have clearly expressed not least through allowing insufficient totex for those preferences to be realised<sup>13</sup> and that “At times, Ofwat has effectively replaced customers’ views with Ofwat’s own narrow understanding of what customers *ought* to want (i.e. low bills). While bills are obviously important to customers their interests are far broader, given the specific challenges for the region and concerns about wider environmental and social impacts<sup>14</sup>”

<sup>4</sup>[https://assets.publishing.service.gov.uk/media/5e8dc457e90e07077abf9a4c/Anglian\\_Water\\_PR19\\_CMA\\_Redetermination\\_Statement\\_of\\_Case\\_Corrected.pdf](https://assets.publishing.service.gov.uk/media/5e8dc457e90e07077abf9a4c/Anglian_Water_PR19_CMA_Redetermination_Statement_of_Case_Corrected.pdf) p.9 & 10 Para 50

<sup>5</sup> Ibid. p.55 (vi)

<sup>6</sup> Ibid. p.3 Para 13

<sup>7</sup> Ibid. p.5 Para 24

<sup>8</sup> Ibid. p.62 Para 277

<sup>9</sup> Ibid. p.4 Para 18

<sup>10</sup> Ibid. p.31 Para 163

<sup>11</sup> Ibid. p.14-15

<sup>12</sup> Ibid. p.5 Para 21

<sup>13</sup> Ibid. p.8 Para 42

<sup>14</sup> Ibid. p.98 Para 401

## Bristol Water

- Argues that it “cannot efficiently finance the delivery of its business plan<sup>15</sup>” and as a small company it requires a ‘company specific adjustment<sup>16</sup>’ (CSA) or Small Company Premium.
- Says Ofwat omitted relevant customer benefits from its assessment of the Small Company Premium. In particular, the value to its customers of it being a local, privately owned company. That its CCG acknowledged that 87% supported the current ownership, even after being informed of the impact on their bills. That “although Ofwat accepted that this was ‘compelling proof of customer support’ for the application of the CSA, it did not take account of this customer benefit in its benefits assessment. That the ‘customer benefits’ test is a misnomer, as Ofwat ties it solely to its perceived value to regulation of other companies, not to the benefit to Bristol Water’s customers”<sup>17</sup>.
- States that Ofwat has wrongly set the penalty rate too high for the ODI for both the mains bursts and per capita consumption performance commitments as a result of failing to consider the strength of consumer views.<sup>18</sup> Argues that customers provided clear evidence for its mains burst ODI that they did not support Ofwat’s increased penalty. That the incentive rates on the PCC ODI are “out of line with the relative importance indicated by our customer views research.”
- States that “Ofwat set a series of rules for not taking a standard approach in calculating ODIs which no companies passed for any of the outcome incentives”, questioning therefore the extent to which the regulator had truly taken on regional feedback<sup>19</sup>.
- Generally highlights the high quality of its engagement. That Ofwat’s Initial Assessment of Plans (IAP) awarded it a B-grade and said it had “A robust, balanced and proportionate evidence base” and “a clear line of sight from the results of its customer research and engagement to the outcomes its business plan will deliver for customers”<sup>20</sup>. States that during the development of its business plan it engaged with 37,000 customers and conducted over 50 pieces of research<sup>21</sup>.
- Said that its Challenge Panel raised more than 600 challenges across its programme of customer research<sup>22</sup> and concluded that its engagement was “high quality” including reflecting customer views in particular in relation to bill reductions, trust, transparency and the environment.
- Says that its approach to financing is in line with customer preferences for stable bills and overall bill levels<sup>23</sup> and that its acceptability research concluded that 93% of customers found its suggested plan acceptable<sup>24</sup>.

<sup>15</sup>[https://assets.publishing.service.gov.uk/media/5e8dc3afe90e0707723adb88/Non-confidential - Bristol Water Statement of Case.pdf](https://assets.publishing.service.gov.uk/media/5e8dc3afe90e0707723adb88/Non-confidential_-_Bristol_Water_Statement_of_Case.pdf) p.2 Para 8

<sup>16</sup> Ofwat assesses whether there is a need for a ‘company specific adjustment’ or ‘CSA’. This is also described as a Small Company Premium (SCP) and the terms can be used interchangeably.

<sup>17</sup> Ibid. p.49 Para 177. Bristol Water says the evidence for this survey is included in Bristol Water’s revised business plan.

<sup>18</sup>Ibid. [p.8 Para 37](#)

<sup>19</sup> Ibid. p.150

<sup>20</sup> Ibid. p. 145 Para 603

<sup>21</sup>Ibid. p.222 Para 29

<sup>22</sup> Ibid. p.224 Para 41. BW says that “All challenges raised were successfully resolved by the Company”. The CCG Chair says “that 25% led to a change in current or future company practice”.

<sup>23</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2019/09/BW04-Financial-Issues-PRV.pdf> p.4 Para 1.2

<sup>24</sup>[https://assets.publishing.service.gov.uk/media/5e8dc3afe90e0707723adb88/Non-confidential - Bristol Water Statement of Case.pdf](https://assets.publishing.service.gov.uk/media/5e8dc3afe90e0707723adb88/Non-confidential_-_Bristol_Water_Statement_of_Case.pdf) p.223 para 34

### Northumbrian Water

- Argues that Ofwat's FD has failed to allow the company efficient costs which if implemented would have "significant adverse consequences" for customers and stakeholders. Including that the company "would expect to see a deterioration in service."<sup>25</sup>
- That Ofwat has "not put enough weight on our customer evidence and preferences and has thus not created the right balance between the Consumer Objective, the Resilience Objective and Financeability Duty."<sup>26</sup>
- States that it has "co-created" its business plan with customers, that its business plan "met the concerns, needs and aspirations of our customers...was shaped by close engagement with around 400,000 customers, interaction with circa 500 stakeholder organisations and constructive challenge from the independent Water Forums<sup>27</sup>." In addition, that this is reflected in the in one of the highest customer acceptability levels in the sector at 91%<sup>28</sup>.
- Says the "Water Forums fully supported our original BP19 plan" and "commended our BP19 both for the level of customer engagement we carried out, and the extent to which it reflected the outcomes of that engagement"<sup>29</sup>
- Fully 'accepts' that "customers' bills should not be higher than they need to be" but feels Ofwat has adopted "a narrow and unbalanced interpretation of the Consumer Objective which focuses unduly on short term bill reductions at the expense of wider consumer preferences"<sup>30</sup>.
- In particular it states "customers told us that they do not want a reduction in bills at the expense of long-term resilience and the risk of increased bills for future generations"; and they "want stable and manageable bills over time." This translated into a preference for flat bills rather than significant decreases in bills in one cycle only to be followed by a rise in the following periods.<sup>31</sup>
- Objects to Ofwat not funding two resilience schemes that its customers strongly supported: for sewer flooding risk reduction in the North East and the Abberton to Hanningfield transfer main designed to tackle potable demand water issues in Essex and Suffolk<sup>32</sup>. Said that its "Flood Risk Reduction enhancement scheme received very strong customer support (71%); the Abberton to Hanningfield transfer main project had 89% support from customers; and the Suffolk resilience scheme had 100% acceptance."<sup>33</sup>
- Highlights that customers wanted the company to plan ahead for climate change, regional population growth and major incidents and supported the company's proposed approach as NWL had shown that this was achievable with a significant reduction in bills.
- That Ofwat's determination would create intergenerational unfairness deferring major investments for other generations to address<sup>34</sup>.
- Says that Ofwat's 3% cap on ODIs is inconsistent with the stated preferences of its customers<sup>35</sup>.

<sup>25</sup>[https://assets.publishing.service.gov.uk/media/5e8dc5f886650c18d05f7f30/NWL\\_PR19\\_Statement\\_of\\_Case\\_2.4.2020\\_PDF.pdf#page=1&zoom=auto,-410,842](https://assets.publishing.service.gov.uk/media/5e8dc5f886650c18d05f7f30/NWL_PR19_Statement_of_Case_2.4.2020_PDF.pdf#page=1&zoom=auto,-410,842) p.4 & 5 Para 11.

<sup>26</sup> Ibid. p.52 Para 235

<sup>27</sup> Ibid. p.38 Summary 4.1

<sup>28</sup> Ibid. p.38 Summary 4.1

<sup>29</sup> Ibid. p.45 Para 187

<sup>30</sup> Ibid. p. 38 Summary 4.1

<sup>31</sup> Ibid.

<sup>32</sup> Ibid. p.6 Para 25

<sup>33</sup> Ibid. p48 Para 208. The framing of the engagement around these schemes warrants particular focus. For example, Did the company engage customers and stakeholders on the need for investment or were customers presented with the task of selecting between a given set of options or which these were the preferred ones? Was any independent information provided in the framing of the discussion?

<sup>34</sup> Ibid. p.52 Para 235

<sup>35</sup> Ibid. p.113 Para 6.6.2

### Yorkshire Water

- Says the determination “is harmful to customers, will damage resilience significantly and is based on flawed methodologies”<sup>36</sup>. In addition, it will create “intergenerational unfairness as it pushes the cost onto future customers” and increases costs overall<sup>37</sup>.
- States that its business plan and long-term strategy was “based on a detailed understanding of customers’ needs and wants” and “drew on the company’s long-standing tradition of working closely in partnership with stakeholders in Yorkshire. This is reflected in the high levels of customer support with 86% of customers finding performance levels, incentives and bill profile acceptable<sup>38</sup>.
- Highlights the high quality of its engagement: its B-rating for engagement by Ofwat in its initial assessment of plans and commendations from the Yorkshire Forum.
- Outlines in detail its research approach and said Ofwat concluded “it provides evidence of a high-quality approach to implementing customer valuation techniques including use of behavioural economics techniques. It provides mostly convincing evidence in its engagement with customers on both the business plan and on longer-term issues<sup>39</sup>”.
- States that Ofwat intervened in 19 of YWS’s 27 performance commitments that had financial incentives to create a package of performance commitments and ODIs that does not meet the *needs* of YWS’s customers, present or future<sup>40</sup>. Argues that Ofwat “replaces the views of YWS customers with the regulator’s own view<sup>41</sup>”. Also, that it “fails to reflect differences between customer preferences across companies.<sup>42</sup>” For example, it says that Ofwat: “Forced customers to accept lower leakage target than the company had been prepared to commit to. Moreover, in the absence of funding even the lower 15% reduction presents a significant challenge to YWS<sup>43</sup>”.
- It states that “Ofwat designed a methodology predicated on a view that genuine differences could exist between companies and that these should be reflected in company incentive rates” but in practice it has now taken an opposing view, saying that there should be limited variation between companies<sup>44</sup>.
- “In summary, Ofwat is now not able to distinguish between genuine differences in customer preferences and ‘measurement error’, because of the very methodology it applied<sup>45</sup>”.

<sup>36</sup><https://assets.publishing.service.gov.uk/media/5e8dc82686650c18cc99f228/ Yorkshire Water - PR19 redetermination Statement of Case 02.04.2020 --.pdf>. p.2 Para 9

<sup>37</sup> Ibid. p.4 Para 14.

<sup>38</sup> Ibid. p.1 Para 5

<sup>39</sup> Ibid. p.25 Para 81

<sup>40</sup> Ibid. p.50 Para 152-153

<sup>41</sup> Ibid. p.51 Para 153 (d)

<sup>42</sup> Ibid. p.58 Para 177

<sup>43</sup> Ibid. p.55 Para 165

<sup>44</sup> Ibid. p.58 Para 178

<sup>45</sup> Ibid. p.58 Para 180

## Companies' criticism of Ofwat's approach to engagement

### Consumer duty

Some companies suggest that Ofwat has failed to satisfy its duty in relation to its regulatory consumer objective because it has not adopted customer preferences. E.g. Anglian Water states that "Ofwat has compromised its consumer duty by disregarding the preferences which the Company's customers have clearly expressed"<sup>46</sup>.

### Ofwat's PR19 Customer Engagement Policy Statement

A number of water companies also argue that Ofwat has gone against its own Customer Engagement Policy Statement by overriding consumer views. In particular, the regulator's decision that: "Companies are best placed to understand and respond to their customers' needs and requirements (Principle 4). This is why we do not want to place ourselves –or any other third party – directly between them and their customers"<sup>47</sup>.

In addition, Yorkshire Water argues that "Ofwat had indicated that it did not intend to make detailed interventions in company ODI packages as it had done in PR14."<sup>48</sup> Yet Yorkshire Water believes it has and this has resulted in customer views, including differences in regional views, not being taken into consideration.

### Walking the talk

Ofwat is also criticised for not 'walking the talk' on engagement in setting the PR19 price control methodology. This includes in the selection of its performance commitments and the level of stretch it requires for some of them. For example, Anglian Water in its Statement of Case highlights that long supply interruptions remain an important concern to customers, but that customers are less concerned about further improvements and have less willingness to pay to address brief interruptions, such as those targeted by Ofwat<sup>49</sup>.

Overall a number of companies say that by ignoring, misinterpreting or giving insufficient weight to consumer views in making its final determinations, Ofwat is undermining the strides made on engagement. As NWL states: "by allowing this precedent to stand we are concerned that the huge gains made by companies in the sector in driving forward ever deeper engagement with their customers may be lost if the output is not given appropriate weight in the determinations."<sup>50</sup>

NWL highlights that the Gray report in 2011 "cautioned" that while the final decision in a price control should sit with the regulator "Ofwat should be careful about substituting its own views for those expressed by or through the consumer representative"<sup>51</sup>.

<sup>46</sup>[https://assets.publishing.service.gov.uk/media/5e8dc457e90e07077abf9a4c/Anglian\\_Water\\_PR19\\_CMA\\_Redetermination\\_Statement\\_of\\_Case\\_Corrected.pdf](https://assets.publishing.service.gov.uk/media/5e8dc457e90e07077abf9a4c/Anglian_Water_PR19_CMA_Redetermination_Statement_of_Case_Corrected.pdf) p.8 Para 42

<sup>47</sup>[https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap\\_pos20160525w2020cust.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap_pos20160525w2020cust.pdf) p.10

<sup>48</sup><https://www.yorkshirewater.com/media/2409/yorkshire-water-pr19-redetermination-statement-of-case-02042020.pdf> p.24 Para 77

<sup>49</sup>[https://assets.publishing.service.gov.uk/media/5e8dc457e90e07077abf9a4c/Anglian\\_Water\\_PR19\\_CMA\\_Redetermination\\_Statement\\_of\\_Case\\_Corrected.pdf](https://assets.publishing.service.gov.uk/media/5e8dc457e90e07077abf9a4c/Anglian_Water_PR19_CMA_Redetermination_Statement_of_Case_Corrected.pdf) p.19 Para 107.

<sup>50</sup> Ibid. p.123 Para 580

<sup>51</sup>[https://assets.publishing.service.gov.uk/media/5eda1e5ee90e071b734d2ca7/Northumbrian\\_Water\\_Reply\\_to\\_Ofwat\\_response\\_27.05.2020\\_NON-CONFIDENTIAL.pdf](https://assets.publishing.service.gov.uk/media/5eda1e5ee90e071b734d2ca7/Northumbrian_Water_Reply_to_Ofwat_response_27.05.2020_NON-CONFIDENTIAL.pdf) p. 123 Para 580

## Companies' use of consumer insights on cost of capital and fair returns

The appealing companies challenge Ofwat's proposed cost of capital and express concerns about the allowed level of company returns which they say will impact their ability to deliver the outcomes that their customers want.

We found no evidence that they had cited their own or wider customer insights on profit levels or the cost of capital to support their arguments in this area in their initial Statement of Case. Nor did we identify any insight as to what consumers deemed to be an overall appropriate level of company returns from the documents we reviewed.

A number of companies have carried out customer research on financing and on issues linked to Ofwat's 'Putting the Sector Back in Balance'<sup>52</sup> agenda. However, it does not seem that any water company carried out customer engagement on the cost of capital, and that while potentially interesting, the financing research undertaken did not specifically focus on understanding customers' views on 'fair profit' or appropriate levels of return.

This was confirmed by the three customer challenge group chairs we spoke to. For example, AW's Customer Engagement Forum Chair said, that despite its summary of insight on fair profits that Anglian Water did not explore these areas "in any meaningful way". NWL Forum Chair, Jim Dixon said he was "not convinced" that research linked to putting the sector back in balance, which the regulator introduced quite late in the day, had the "same degree of robustness" as engagement on core issues such as water dis-colourisation. Yorkshire Water's Forum Chair, highlighted that the cost of capital was outside of the CCG brief.

Bristol Water Challenge Panel's assurance report to Ofwat on the company's business plan also notes in relation to its financing related consumer engagement that: "in response to a challenge from the Challenge Panel, Bristol Water said there was not much discussion on profit and it didn't influence the outcomes from the [finance] game<sup>53</sup>."

CCW also reported that it isn't aware of any specific research or good practice done on cost of capital or fair returns as part of PR19<sup>54</sup>. However, it flagged that it is doing some research with its new online community 'WaterVoice' about what customers would like companies to do with unplanned profit, which will be published in the summer.

However, in line with Ofwat's methodology, companies have conducted engagement on company rewards and penalties (which form part of overall returns) and this is used to varying degrees in the calculation of outcome delivery incentives<sup>55</sup>.

The following company research may be worth particular exploration if Citizens Advice or the CMA wishes to explore this further:

- Bristol Water engaged with customers on financing issues such as gearing, Pay As You Go and Regulatory Capital Value run-off rates (paying for investment now or spreading the cost and what proportion of bills should be financing costs). This reportedly included a full day deliberative workshop and gamification<sup>56</sup>. The CCG stated that it didn't have the opportunity

<sup>52</sup> Ofwat's 'Putting the Sector Back in Balance' statement was published in July 2018. It outlines how the regulator expects companies to demonstrate how it has balanced the interests of customers and those of investors. This included companies being transparent about their policies for performance related pay and dividends. <https://www.ofwat.gov.uk/wp-content/uploads/2018/04/Benefit-sharing-decision-statement-FINAL-for-publishing.pdf>

<sup>53</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2018/09/BWCP-Assurance-Report.pdf> p.28 Para 5.4

<sup>54</sup> By email 13 June 2020.

<sup>55</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2018/03/Aide-Memoire-for-Customer-Challenge-Groups.pdf>

<sup>56</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2018/09/Section-C1-Engagement-Communication-and-Research-1.pdf> p.32



to comment on the research materials, but it did note that the current bill was presented “in the context of its primary components (including interest and profit) to obtain opinions on the cost of finance and the level of profit both before and after a game was completed. The outcome was that customers preferred to borrow more to keep the bill as low as possible but didn’t want financing elements to become a dominant part of the bill”<sup>57</sup>. The CCG also stated: “During attendance at the Customer Forum, the Challenge Panel was aware of some anti-private, anti-profit and dividend sentiment but these views were very much in the minority and there does not appear to be evidence of significant unease around Bristol Water’s governance structure”.<sup>58</sup>

- Yorkshire Water reports it carried out engagement on ‘Ownership and Nationalisation’, which included comparative performance, financial structures, director remuneration and payment of taxes. There does not appear to be detail on the scope, methodological approach or insight in the engagement appendix we reviewed but the company’s full research report may have some interesting insights.<sup>59</sup>
- Anglian Water undertook ‘financial fairness’ engagement. In addition, its wider acceptability research says that over 90% of each of the customer groups found Anglian Water’s proposed plan relating to ‘Fair Profits and Smarter Ways of Working’ acceptable, with the exception of vulnerable customers where the proportion dropped to 84%. Respondents in the 18-25 age category were significantly more likely to find the plans acceptable than were those in each of the older age groups. Of the 156 respondents who said that they found this element of the plan unacceptable, the main reasons given were: profit margins too high/above rate of inflation(21%); shareholders prioritised over customers (17%); too much money going to shareholders (12%); profits should be re-invested –not paid to employees/shareholders (10%); and water services should be taken back into public ownership (8%). It may be worth exploring this in more detail.<sup>60</sup>.
- Northumbrian Water carried out ‘Our Finances Explained’ research to understand how to better communicate their company’s financing arrangements transparently. This included discussions with customers on revenue generated from customer bills; capital investment; debt markets and borrowing; interest; taxation; profit; reinvestment and shareholder dividends<sup>61</sup>.

<sup>57</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2018/09/BWCP-Assurance-Report.pdf> p.28

<sup>58</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2018/09/BWCP-Assurance-Report.pdf> p.54

<sup>59</sup> <https://www.yorkshirewater.com/media/1962/appendix-5a-customer-and-stakeholder-engagement.pdf> p.44 Para 6.10

<sup>60</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/pr19-12c-anglian-water-customer-engagement-report-14-Aug-2018.pdf> p.255

<sup>61</sup> [https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated\\_appendix\\_2.2\\_compendium\\_of\\_customer\\_engagement\\_summaries\\_for\\_pr19\\_nwg\\_-\\_resubmission\\_april\\_2019.pdf](https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated_appendix_2.2_compendium_of_customer_engagement_summaries_for_pr19_nwg_-_resubmission_april_2019.pdf) p.72

## Ofwat's response to company engagement arguments in their Statement of Cases

### Overview

Ofwat believes that the companies' "submissions reflect either a misapprehension or a misrepresentation of the purpose of companies' customer engagement programmes<sup>62</sup>."

In general, the regulator disputes that it has given insufficient weight to or ignored customer views and says it "had full regard to customer preferences" and that these were "instrumental in shaping the final determinations<sup>63</sup>".

In its response to each Statement of Case, to varying degrees, it outlines how it has considered, evaluated, and weighed customer research and the resultant insight in its decisions alongside wider evidence.

The regulator highlights that its Methodology also states clearly that customer engagement was not intended to replace either the role or judgement of Ofwat. As Engagement Principle 7 outlines in its Customer Engagement Policy Statement: "The final decision on price limits is entrusted to Ofwat. We will use a risk-based approach to challenge company plans if this is necessary to protect customers interests.<sup>64</sup>" Though there is no detail on what the 'risk-based' approach entails.

Ofwat says that its approach recognises that there are "areas where customers are not best placed to determine whether a company's business plan is appropriate" and that despite the four companies positive engagement IAP test grades, that it is "important to recognise that companies' customer research varies in quality and can only ever imperfectly capture customers' actual preferences. It would therefore be a derogation of our responsibility as a prudent regulator not to scrutinise, and where appropriate, challenge the results of companies' customer research, based on the wider set of information available to us<sup>65</sup>."

Furthermore "that customer views are just one of the inputs that it asked companies to consider in particular in setting stretching performance commitments and that the regulator has applied a wider set of tests than just evidence of customer support (including cost benefit analysis, comparative and historical information, minimum improvement possible, maximum level attainable and expert knowledge).<sup>66</sup>"

In support of its final determination Ofwat also highlights the high levels of customer acceptability for its four draft determinations reported by CCW research.

In particular, it argues that "customers' stated preferences should not be confused with judgements as to the efficiency or otherwise of companies' proposed plans. Customers are not well placed to make such judgements. But that it can be safely assumed that no customer wants to pay for inefficiency.<sup>67</sup>"

<sup>62</sup> [https://assets.publishing.service.gov.uk/media/5eb15fa7e90e0723b3636e74/001\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Introduction\\_and\\_overall\\_stretch\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb15fa7e90e0723b3636e74/001_-_Reference_of_the_PR19_final_determinations_Introduction_and_overall_stretch_002_.pdf) p.43 Para 3.110

<sup>63</sup> Ibid. p.44 para 3.117

<sup>64</sup> Ibid. p.44 Para 3.114

<sup>65</sup> Ibid. p.44 Para 3.115

<sup>66</sup> Ibid. p.43 Para 3.113

<sup>67</sup> Ibid. p.44 Para 3.117

Ultimately, for all four companies, Ofwat believes that its final determination ensures that the company has adequate funding to deliver the outcomes in the business plan, thereby protecting current and future consumers<sup>68</sup>.

### **Ofwat's company specific feedback**

In addition to the arguments above, which are common to all companies, we highlight below some of Ofwat's company specific feedback on engagement arguments:

#### Anglian Water

Ofwat:

- Says "The company wrongly presents the issue as a binary choice between long-term investment and short-term bill reductions. This is a false dichotomy".
- That it did not challenge any proposed spending on the basis of need but "allowed for efficiently incurred costs in our final determination, including investment for the long term. Anglian Water has not demonstrated that its customers would prefer a profile of higher bills if this is not efficiently incurred and it is reasonable to assume that no customer would wish to fund inefficient expenditure."<sup>69</sup>
- Taking into account inflation it would have expected to see average bills remain stable across the five years<sup>70</sup> - consistent with customer preferences.
- Despite the high quality of engagement, queries the quality, interpretation and application of some of the company's research e.g. on supply interruptions and the application of willingness to pay in calculating some ODI rates and outperformance payments<sup>71</sup>. Goes on to say that leakage is a clear example of where the company "misuses the results of its customer engagement to propose an enhanced ODI package that is not in its customer interests"<sup>72</sup>.
- Notes that recent research by CCW revealed that 86% of Anglian Water's customers found Ofwat's draft determination plan and bill reductions acceptable<sup>73</sup>.

#### Bristol Water

Ofwat:

- Says BW provided evidence of "elements of high-quality customer engagement" but that in its IAP it also highlighted "areas of concern" such as how it used customer research in relation to ODIs<sup>74</sup>.
- Disagrees that it has set excessively high underperformance ODI rates for burst mains/mains repairs and per capita consumption and finds "some (although not all) of the company's research to be poor quality and vulnerable to bias." Argues its approach is "better aligned" to customers' preferences and interests. That it has "used high-quality elements of the company's customer research alongside industry comparative data, as well as recognising areas of poor past performance when setting these ODI rates"<sup>75</sup>.
- Proposes that "Bristol's proposed changes to the final determination would result in excessive company returns to shareholders and would reward inefficiency at the expense of its customers"<sup>76</sup>.

<sup>68</sup> In the Executive Summary of Ofwat's response to each of the four appealing companies Statement of Case.

<sup>69</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2020/05/Reference-of-the-PR19-final-determinations-response-to-Anglian-Waters-statement-of-case.pdf> p.15 para 1.62

<sup>70</sup> Ibid. p.4 Para 1.13

<sup>71</sup> Ibid. p.145, Para 4.56

<sup>72</sup> Ibid. p.150 Para 4.74

<sup>73</sup> Ibid. p.30 para 2.25

<sup>74</sup> [https://assets.publishing.service.gov.uk/media/5eb15ec6e90e0723b4a8056b/003\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Response\\_to\\_Bristol\\_Waters\\_statement\\_of\\_case\\_002.pdf](https://assets.publishing.service.gov.uk/media/5eb15ec6e90e0723b4a8056b/003_-_Reference_of_the_PR19_final_determinations_Response_to_Bristol_Waters_statement_of_case_002.pdf) p.21 para 2.9

<sup>75</sup> Ibid. p.14 para 1.57

<sup>76</sup> Ibid. p.2 Para 1.4

- Says that recent research by the Consumer Council for Water (CCW) revealed that 89% of Bristol Water’s customers found its draft determination plan and bill reductions acceptable, comparable to the company’s research findings on overall plan acceptability of 93%<sup>77</sup>.
- Does not appear to highlight any concerns about the independence of the Bristol CCG as it has in the three other company responses. Indeed, the BWCP notes that “Ofwat has commended the thoroughness of the work of the Challenge Panel”<sup>78</sup>.

### Northumbrian Water

Ofwat:

- Acknowledges the level of customer support for the plan and the positive comments from the Water Forums but said it felt the need to intervene to protect customers from the risk of inefficient costs, duplicated costs and excessive returns to investors<sup>79</sup>.
- Recognises that the company’s plan demonstrates high-quality engagement with customers. However, for some ODIs said “we were concerned how the company calculated the marginal benefit values for its outcome delivery incentive rates from one source and the company did not provide convincing evidence that this single piece of research was high quality or that it had been triangulated with other customer valuation research.”<sup>80</sup>
- Says its final determination also retained Northumbrian Water’s proposed ODI rates where the company had provided high-quality evidence that these reflected customers’ preferences and would incentivise performance improvement. For example, for the per capita consumption performance commitment. Where it did not consider the company’s evidence to be sufficient, it said it intervened to set alternative ODI rates.
- Believes that Northumbrian Water has a poor understanding of resilience and disputes the need to provide additional funding for two specific proposals: for the Abberton-Hanningfield raw transfer scheme proposal in Essex and to reduce sewer flooding risk in the North East<sup>81</sup>.
- That despite the company’s “poor understanding of resilience” that “we recognised this was a priority to the company and its customers and stakeholders” and this is reflected in its decisions<sup>82</sup>.
- Highlighted that “at final determination our assessment of the company’s proposed dividend policy showed that the company was falling well short in a number of areas with too much focus on distribution to shareholders and insufficient weight given to customers’ interests<sup>83</sup>.
- Noted that recent research by CCW revealed that 90% of Northumbrian Water’s customers found Ofwat’s draft determination plan and bill reductions acceptable, comparable to the results of the company’s research findings on overall plan acceptability<sup>84</sup>.

<sup>77</sup> Ibid. p.21 Para 2.12

<sup>78</sup> [https://www.bristolwater.co.uk/wp-content/uploads/2019/09/BWCP\\_AnnualReport2019\\_ArtworkDigital.pdf](https://www.bristolwater.co.uk/wp-content/uploads/2019/09/BWCP_AnnualReport2019_ArtworkDigital.pdf) p.30

<sup>79</sup> [https://assets.publishing.service.gov.uk/media/5eb15ef8d3bf7f65241db096/004\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Response\\_to\\_Northumbrian\\_Water\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb15ef8d3bf7f65241db096/004_-_Reference_of_the_PR19_final_determinations_Response_to_Northumbrian_Water_002_.pdf) p.22 para 2.25

<sup>80</sup> Ibid. p.72 para 4.3

<sup>81</sup> Ibid. p.9 Para 1.32 onwards

<sup>82</sup> Ibid. p.9 Para 1.33

<sup>83</sup> Ibid. p.6 Para 1.21

<sup>84</sup> Ibid. p.23 Para 2.29

## Yorkshire Water

### Ofwat:

- Argues that Yorkshire is a relatively poor performer and it had to step in at PR19 to protect customers interests<sup>85</sup>.
- Regarding the material changes to YW's ODI package it said:
  - that in some cases it intervened to better align the company's ODI rates with the results of its own valuation research i.e. "to remedy cases where the company had misrepresented the results of its underlying research, for example due to poor quality triangulation<sup>86</sup>."
  - That overall, it has "largely preserved" the customer "pattern of preferences".
  - That its proposed interruptions target now better reflects customers preferences as the ODI rate is set using the companies' willingness to pay value from the company's main stated preference research.
  - That Yorkshire Water's per capita consumption ODI was not based on its customers' calculation for reducing per capita consumption<sup>87</sup>.
- Re leakage, that while Yorkshire Water's proposed ODI rate was the most stretching level in the sector, it adjusted it down for a number of reasons which it documents. These include but are not limited to: it did not consider that the company provided sufficient evidence to demonstrate that customers supported the 25% reduction and the proposed underperformance ODI rate was materially below the industry average<sup>88</sup>. In addition, Ofwat notes that it broadly respected the relative ranking of customer preferences for leakage compared to other common performance commitments. Furthermore, it highlights that there is "nothing in final determination to stop Yorkshire Water from reducing leakage by 25% in line with customer preferences" and that if it did, "it would earn outperformance payments for the reduction it made above the 15% which we set as the efficient reduction to be made within our cost allowance"<sup>89</sup>.
- After taking into account inflation it would expect to see average customer bills remain stable across the five-year period<sup>90</sup>.
- States that recent research by CCW revealed that 88% of Yorkshire Water customers found its draft determination plan and bill reductions acceptable, comparable to the company's research findings on overall plan acceptability of 86%.<sup>91</sup>

<sup>85</sup> [https://assets.publishing.service.gov.uk/media/5eb15f37d3bf7f6521c3f6ec/005 -  
Reference of the PR19 final determinations Response to Yorkshire Waters statement of case 002 .pdf](https://assets.publishing.service.gov.uk/media/5eb15f37d3bf7f6521c3f6ec/005_-_Reference_of_the_PR19_final_determinations_Response_to_Yorkshire_Waters_statement_of_case_002_.pdf) p.2 Para 1.2

<sup>86</sup> Ibid. p.21 Para 2.22

<sup>87</sup> Ibid. p.21 Para 2.25 onwards

<sup>88</sup> Ibid. p.92 Para 4.66

<sup>89</sup> Ibid. p.7 Para 1.28

<sup>90</sup> Ibid. p.25 Para 2.40

<sup>91</sup> Ibid. p.24 Para 2.33

## Customer Challenge Groups' views on company engagement

Ofwat set an expectation that all companies would have a customer challenge group (CCG). Their primary role was to provide independent challenge to companies and independent assurance to the regulator on the quality of a company's customer engagement and the degree to which this is reflected in its business plan. The groups are not expected to endorse a company's overall business plan, nor did the regulator expect them to act as a substitute for the views of customers.

The following summary is based on CCG publications in the public domain, information on the CCGs' websites and a short interview with the CCG Chairs for Anglian Water, NWL and Yorkshire Water. It has been reviewed for accuracy by all CCG Chairs, including by Bristol Water's CCG Chair.

### Overview

The CCGs have adopted different positions in relation to their respective company's appeals but there are some common customer themes among three of the four CCGs (excludes Bristol Water Challenge Panel): a recognition of customers' desire for stable and affordable bills; a willingness to accept slightly higher bills over bill cuts if these are required to maintain or deliver service enhancements and resilience; a desire "not to kick the can down the road" in terms of funding for the future, and concerns that the final determination could have unintended consequences when it comes to delivering the outcomes customers have supported, reflected in high levels of customer acceptability.

### CCG company specific views

#### Anglian Water's Customer Engagement Forum:

- Is "not endorsing Anglian Water's business plan" (nor Ofwat's FD) but states that they believe Anglian's overall engagement was "very good quality", reflected in it being the only company to be A-rated for its engagement by Ofwat in its IAP. Also, that certain aspects, such as willingness to pay and triangulation are "leading edge"<sup>92</sup>.
- Welcomes the referral to the CMA as there appears to be a difference of opinion between the regulator and Anglian Water as to whether the outcomes consumers have expressed they want could be delivered given the final determination. Thinks particular weight should be put on Anglian's engagement findings given its A-rating.
- The Chair Jeff Halliwell confirmed that despite the CCG's "initial concerns" and "surprise by the strength of opinion" that they are "convinced" customers were willing to pay a little bit more for service improvements "as long as the 20% of customers unable to afford their bills are taken care of". Also, that customers were clear that in terms of investing for the future, they "did not want to kick the can down the road".
- States that in assessing its research, "the CEF worked on the assumption that the company was providing consumers with a fair choice between outcomes and cost, as part of the customer engagement to inform its Business Plan<sup>93</sup>". This may or may not be the case as Ofwat claims, which would likely have impacted customer views.
- The Chair agrees with CCW that the engagement referenced post business plan submission "was impacted by the short amount of time allowed by the process" and said the CEF didn't have as long to comment. However, he says that this should not detract from the quality of the overall research programme.

<sup>92</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/anh-customer-engagement-pr19-report.pdf> p.11

<sup>93</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/cef-draft-response-to-aw-dd-submission.pdf> p.5

### Bristol Water Challenge Panel (BWCP)

- “Understands that the ability for Ofwat to have a greater perspective on the business plans from across the industry means that customer preferences may need to be balanced against political, environmental, economic and technological drivers.<sup>94</sup>”
- In general terms, says the customer engagement is “high quality”<sup>95</sup> and “grounded in very sound extensive customer engagement, the results of which can be seen throughout the plan and in particular in the proposed outcomes, promises, service commitments and targets.”<sup>96</sup>
- Says that company’s triangulation approach and the post draft determination research on ODIs and the social tariff represents “best practice” customer engagement<sup>97</sup>.
- Highlights on research regarding Small Company Premium “that when informed about the reduction from £3 per annum to £1.80 per annum, 87% of customers indicated they were content to pay this cost. Customers indicated they support the Premium because they support local companies providing local services, and given bills are already lower than the national average, they indicated they were happy to pay this additional amount.” And this was consistent with the findings of research the year before in 2018<sup>98</sup>.
- Highlights that it has received assurances from Bristol Water that Ofwat’s proposed efficiency savings are “achievable” and “do not place the customer at greater risk of higher bills or make the company less capable of being a going concern”<sup>99</sup>.
- States that the post draft determination engagement “indicates that customers feel the changes to the incentives in the DD are harsher than expected, and in places at odds with local customer preferences”. Customers are for example looking for “a better balance of incentives than in the DD otherwise the company may focus on service areas with big penalties and ignore other areas which are of more concern to customers”<sup>100</sup>.
- States “that Bristol Water’s research showed that customers preferred a slower path towards asset improvements than the company originally set out in its business plan while also keeping bills low”<sup>101</sup>.

### Northumbrian and Essex and Suffolk Water Forums

- Say that their role is to ask “was the customer voice heard [by the company] and acted upon when the decisions were made? Rather than ‘was the decision the right one’.
- While it acknowledges that there are always limitations to research, believes that the company’s engagement process was a proportionate, “iterative process” “rigorous and engaging”. They were pleased to see that the regulator acknowledged the high-quality of the company’s customer engagement and the impact it had had on the Business Plan.
- Nonetheless they highlight the “view that implementing the DD would deliver a plan that is different in some fundamental ways from the one that customers gave very strong support for (91%), and that they are expecting to be delivered – particularly in terms of resilience for the future”<sup>102</sup>.
- While they welcome Ofwat’s focus on reducing bills, the CCG believes that the regulator has moved much too far towards bill reduction; and they remain concerned about the in the round impact this will have. It states, “during NWL’s research customers were clear – they

<sup>94</sup> BWCP response to Ofwat’s draft determination <https://www.bristolwater.co.uk/about-us/our-customers/#challenge-panel> p.1  
<https://www.bristolwater.co.uk/wp-content/uploads/2018/09/BWCP-Assurance-Report.pdf> p.5

<sup>96</sup> Ibid. p.61 Para 12.8

<sup>97</sup> BWCP response to Ofwat’s draft determination - <https://www.bristolwater.co.uk/about-us/our-customers/#challenge-panel>

<sup>98</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2019/06/BWCP-IAP-Report-March-2019-Final.pdf> p.11

<sup>99</sup> BWCP response to Ofwat’s draft determination - <https://www.bristolwater.co.uk/about-us/our-customers/#challenge-panel>

<sup>100</sup> Ibid. Conclusions

<sup>101</sup> Ibid. p.4

<sup>102</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/12/Northumbrian-Water-Forums-Response-to-Ofwat-PR19-Draft-Determination-for-Northumbrian-Water.pdf> p.2

wanted to see some of the cost savings reinvested in enhancement projects rather than in a bill reduction beyond that which they gave support for.<sup>103</sup>

- Raise concerns, in particular, about the exclusion of the Abberton to Hanningfield scheme to enhance security of supply in the south and about a scheme to reduce sewer flooding in the North, where the company carried out “excellent engagement” and which received strong customer support<sup>104</sup>. In the CCG’s words, not investing in them “does not make sense especially when customers say they support it; that if the investment is not made now that the issues risk becoming more acute by the next price control and therefore could be more costly to address affecting future consumers.<sup>105</sup>
- In particular, the Forums are seeking assurances that the final determination will not put customers at greater risk. In *their words* “as we have observed, past industry experience shows that if costs are squeezed too much then areas that can suffer are general asset maintenance and climate change resilience, damaging companies’ ability to deliver for customers today and in the future”<sup>106</sup>.

### Yorkshire Water’s Forum

- Has shifted its position since the draft determination from being concerned that customer outcomes would not be delivered as a result of Ofwat’s decision, to now feeling “strongly that the high levels of service which Ofwat proposes, and which it otherwise endorses, cannot be achieved within the costs allowed in the DD<sup>107</sup>”. The chair explained this change in stance was because of information that had been shared with the group by Ofwat and the company subsequently.
- States that the company’s “survey work was extensive, thorough and comprehensively audited and, in the opinion of the Forum members, fully captured the attitudes and opinions of Yorkshire Water customers.” Concluded that there is a “clear golden thread between Yorkshire Water’s business plan development and what its customers are telling the company<sup>108</sup>.”
- Commended Yorkshire Water on “delivering high quality customer research within a very demanding timescale and for the extent of the consultation with the Forum. We believe that Yorkshire Water has gone to great lengths to understand what its customers want, and that this outcome has not been reflected in the final determination.<sup>109</sup>”
- Says that “Yorkshire Water’s customers overwhelmingly supported the company’s business plan and requested stable bills. Whilst the Forum would be willing to support lower bills for customers, it would not be acceptable for high priority customer-supported schemes to be compromised because of financial constraints<sup>110</sup>.”
- Its Chair Andrea Cook explained that the Forum think “the balance of Ofwat’s decision between investment priorities and customer priorities is wrong”. That different regions have different priorities and that Yorkshire’s residents “don’t want to live in fear of river and sewerage flooding.” She highlighted that “Yorkshire Water has always been regarded as an efficient company with historically a low bill.” In addition, that in terms of inter-generational fairness, customers don’t want “to kick the ball down the road.”

<sup>103</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/12/Northumbrian-Water-Forums-Response-to-Ofwat-PR19-Draft-Determination-for-Northumbrian-Water.pdf> p.2

<sup>104</sup> Ibid. p.4 Para 3

<sup>105</sup> [https://assets.publishing.service.gov.uk/media/5ebebda686650c27984d2b9b/Northumbrian\\_and\\_Essex\\_and\\_Suffolk\\_Water\\_Forums.pdf](https://assets.publishing.service.gov.uk/media/5ebebda686650c27984d2b9b/Northumbrian_and_Essex_and_Suffolk_Water_Forums.pdf)

<sup>106</sup> Ibid. The Conclusion

<sup>107</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/12/Yorkshire-Forum-for-Water-Customers-Response-to-Ofwat-PR19-Draft-Determination-for-Yorkshire-Water.pdf> p.3

<sup>108</sup> <https://www.yorkshirewater.com/media/2496/yorkshire-forum-for-water-customers-pr19-assurance-report.pdf> p.16

<sup>109</sup> [https://assets.publishing.service.gov.uk/media/5ebec05be90e071e37cfd1cf/Yorkshire\\_Forum\\_for\\_Water\\_Customers.pdf](https://assets.publishing.service.gov.uk/media/5ebec05be90e071e37cfd1cf/Yorkshire_Forum_for_Water_Customers.pdf) p.1

<sup>110</sup> Ibid.



- Raise concerns that “many of the common PCs mandated by Ofwat have much lower levels of support than the bespoke commitments proposed by the company.
- Feels the company’s post IAP research is high-quality and robust<sup>111</sup>.

## CCW’s views on the appealing companies’ engagement related arguments

CCW is the statutory watchdog for water consumers. The information below is taken from CCW’s public submissions to the CMA and has been checked with the watchdog.

### Overview

In its responses to each appealing water company’s Statement of Case, CCW strongly welcomes Ofwat’s challenge to all companies on efficiency. It says that it wants consumers’ views to be considered but that it also knows that customers expect any bill changes to be fully justifiable.

It believes that in a number of places customers have clearly shown they want investment for the future so consequently CCW wants this reflected in the final determination if the evidence shows that customers want it, and the proposed costs and the technical case for investment are credible. It calls on the CMA to show in its redeterminations, if it confirms the efficiency challenges applied, that resources are sufficient to meet customer expectations.

CCW says that there is evidence that customers have reservations about the use of company incentives, especially in areas of service that customers consider to be service failures e.g. sewer flooding, or that customers consider to be part of the company’s ‘day job’. It argues that this is reflected in the decline in acceptability of the business plans when ODI rewards are added. Consequently, it supports “a greater weighting on potential penalties in the ODI package to strengthen the incentives to prevent failure.” Any rewards available to the company should in its view reflect challenging and stretching performance targets.

In addition, CCW’s April 2020 report ‘Engaging water customers for better consumer and business outcomes’, while recognising the value of engagement, “found that most participants struggle with some elements of what they are asked [consulted on] and “for some things, they would prefer ‘experts’ to be consulted on their behalf.” Overall, that “raises important questions about the validity of the information that water companies are acting on, especially for business planning, where consumers are asked about services and service levels that are unfamiliar or abstract to them. There are questions too about the processes used to pilot research materials before they are used on consumers.<sup>112</sup>”

In terms of this report’s recommendations, CCW said that it supports calls for greater transparency on how customer evidence was used (or not used) in Ofwat’s regulatory decisions, including how customer evidence was weighted against the other factors taken into account in its assessments<sup>113</sup>.

<sup>111</sup> <https://www.yorkshirewater.com/media/2162/response-to-the-iap-from-the-yorkshire-forum-for-water-customers.pdf> p.2

<sup>112</sup> <https://www.ccwater.org.uk/wp-content/uploads/2020/05/Engaging-water-customers-for-better-consumer-and-business-outcomes.pdf> p.2

<sup>113</sup> By email 22/06/2020

### **CCW's company specific view on their engagement arguments**

We summarise CCW's additional views on company specific engagement arguments below:

#### Anglian Water

CCW<sup>114</sup>

- Believes that the Anglian Water's final determination is a good package for customers as the package of PCs and investments reflects customer priorities and is based on sound evidence from customer research.
- The exceptions to the latter are the ODIs for internal sewer flooding and the importance of reducing per capita consumption (PCC) where they argue that the CMA should "take into account the rate of reward relative to stretch and reassess if this is appropriately balanced."
- Believes customers have clearly shown they want investment for the future so would not want to see any reduction in maintenance activity.
- Is "supportive of Anglian's research which informed its business plan and notes that it adhered to CCW's triangulation principles. However, it cites some weaknesses:
  - Misrepresentation of customer research in some parts of the submission
  - The complexity of its acceptability research and its engagement on the draft determination, which led CCW "to question the extent to which customers would have been able to reach meaningful decisions across every measure that was presented."
  - Anglian's post Draft Determination (DD) research, which compared Anglian's plan with Ofwat's DD, which they believe is "leading and we therefore advise that you place limited emphasis on these findings. Unusually, perhaps because of the urgency of the exercise, there was limited engagement of the CEF subgroup on customer engagement in the design of this survey". In this research two thirds of customers preferred Anglian's plan to Ofwat's.
- Highlights that its research found acceptability levels of 87% on an uninformed basis and 86% on an informed basis for the draft determination. It concludes that as the change between draft and final determination has been minor, they'd expect similar levels of acceptability for the final determination.
- Highlights that its own research shows that customer acceptability reduced from 86% to 77% when customers were presented with the potential impact of Anglian's ODIs on their bills over the period. This is in line with Anglian's own research which showed 77% of customers supported the principle of ODIs.

#### Bristol Water<sup>115</sup>

CCW:

- Wants the Ofwat FD package of prices, service performance commitments and investment to remain because it reflects customer supported priorities and areas of service where the company needs to improve.
- Does not support Bristol's claim for an uplift to the Weighted Average Cost of Capital (WaCC). It does not believe that Bristol, or any company, should receive a Small Company Premium (SCP) in the absence of value added to offset the impact on bills. It says that this would "look perverse" to customers and would fail to incentivise Bristol and other small companies to find ways of adding value or of mitigating any additional costs caused by their scale. However, CCW provides no customer evidence to support this.

<sup>114</sup>[https://assets.publishing.service.gov.uk/media/5e3986650c27955a89bb/The\\_Consumer\\_Council\\_for\\_Water\\_\\_Anglian\\_\\_submission\\_redacted\\_.pdf](https://assets.publishing.service.gov.uk/media/5e3986650c27955a89bb/The_Consumer_Council_for_Water__Anglian__submission_redacted_.pdf)

<sup>115</sup>[https://assets.publishing.service.gov.uk/media/5e39e071e366db2ae/The\\_Consumer\\_Council\\_for\\_Water\\_\\_Bristol\\_\\_submission\\_redacted\\_.pdf](https://assets.publishing.service.gov.uk/media/5e39e071e366db2ae/The_Consumer_Council_for_Water__Bristol__submission_redacted_.pdf)

- States that the company's engagement on special cost factors with its Customer Forum was a qualitative research exercise using a small sample of customers; that there were limitations on this research given customers' assumptions; and that it should be considered as an indicative view only, not a comprehensive measure of Bristol Water customers' opinions or support for a SCP for Bristol.
- Thinks Bristol's engagement approach was "ambitious, clearly thought through" and adhered to CCW triangulation principles. That "overall" BW's plan accurately reflected its customers views and that CCW is content that its PCs and ODIs are appropriate and based on customer priorities established through engagement and research, at bill levels they find acceptable.
- Highlights that BW's research found that 90% of customers consider stable bills important for budgeting purposes, which suggests little appetite for the bill volatility large ODI rates produce.
- Notes that Ofwat's draft determination received a very high level of customer acceptability in CCW's research with 91%. As the package is not significantly different it seems likely that the final determination would attract a similar level of acceptability. Therefore, it does not believe that the high level of acceptability for Bristol Water's plan means customers support the inclusion of a SCP.
- Highlights when testing the draft determination, customer acceptability dropped from 93% (uninformed) and 89% (informed), to 79% once they saw the potential bill effect of ODIs. Notes that customers preferred a package that would impact bills by no more than £4 a year.

NWL<sup>116</sup>

CCW:

- States that the "the company's plan reflected evidence of customer' priorities and expectations".
- Agreed that NWL's customer engagement for its business plan shows that customers preferred having a smaller bill reduction than ultimately appeared on Ofwat's FD, with increased investment to improve resilience, including to reduce sewer flooding risk in the North East and water supply demand in Essex and Suffolk.
- Said that NWL's business plan offered short-term bill reductions for customers alongside investment to improve asset resilience to benefit future customers, based on credible and robust evidence of customers' views. The exception to the latter was NWL's customer research into ODIs.
- Overall is supportive of Ofwat's Final Determination and It wants to see the package of outcomes and performance commitments retained in the CMA's determination.
- Says the FD reflects customer supported priorities and areas of service where the company needs to improve. Also, CCW research on the DD found high levels of customer acceptability with 87% uninformed/86% informed. It is reasonable to assume that customers would view the FD on a similar basis.
- Lastly, argues particular consideration should be given by the CMA to investment to secure longer-term resilience to reduce sewer flooding risk in the North East and water supply demand in Essex and Suffolk.

<sup>116</sup>[https://assets.publishing.service.gov.uk/media/5ebefb18e90e071e2f955eae/The\\_Consumer\\_Council\\_for\\_Water\\_\\_Northumbrian\\_\\_sub\\_mission\\_redacted\\_.pdf](https://assets.publishing.service.gov.uk/media/5ebefb18e90e071e2f955eae/The_Consumer_Council_for_Water__Northumbrian__sub_mission_redacted_.pdf)

Yorkshire Water<sup>117</sup>

CCW says:

- Overall, it considers Yorkshire Water’s research and engagement programme to be of general good quality and that the company followed the CCW triangulation guidance. In addition, there was a clear thread in the business plan demonstrating where the company’s research and customers’ priorities had informed the company’s Five Big Goals through its Total Value Impact Assessment approach. But flags concerns with some of Yorkshire Water’s research including in relation to ODI payments and the sample size for its acceptability research.
- Thinks that overall Ofwat’s Final Determination for Yorkshire Water is a “good package” as it reflects customers’ priorities and is generally based on sound evidence”. That CCW are supportive of Ofwat’s interventions on PCs where Yorkshire Water is currently a poor performer. In addition, the bill change is acceptable for customers.
- However, it wants to be certain that the investment allowed to address flooding in Hull is right.
- Is disappointed that Yorkshire Water is now expected to deliver only a 15% reduction in leakage after making a public commitment to deliver a 40% reduction (from 2017 levels). This has raised customers’ expectations of a more substantial improvement in a high priority area of service. Highlights that Yorkshire Water officials advised stakeholders that this target was not dependent on specific funding in PR19.
- Highlights that a high proportion of Yorkshire Water’s customers thought that Ofwat’s Draft Determination proposals were acceptable - 91% of uninformed customers and 89% of informed customers said the plan was either “acceptable” or “very acceptable. As there are no significant differences between DD and FD many customers are likely to find the FD acceptable.

<sup>117</sup>[https://assets.publishing.service.gov.uk/media/5ebebfaee90e071e2d2aca4a/The\\_Consumer\\_Council\\_for\\_Water\\_\\_Yorkshire\\_\\_submission\\_redacted\\_.pdf](https://assets.publishing.service.gov.uk/media/5ebebfaee90e071e2d2aca4a/The_Consumer_Council_for_Water__Yorkshire__submission_redacted_.pdf)

## PART 2: ASSESSING THE VALUE OF ENGAGEMENT

### Overview

A key challenge for the CMA is understanding the robustness of engagement findings and to what extent to value and weight these in making its decisions.

Assessing the quality of engagement is notoriously difficult and time consuming to do well. The pros and cons of different research techniques are well documented and not always agreed<sup>118</sup>. This is made more challenging in this context by the lack of any real consensus across the water sector and between companies, CCW, the CCGs, and the regulator as to what good practice really looks like. For example, benchmarks referenced by water companies included but were not limited to:

- Ofwat's high-level principles for engagement outlined in its Customer Engagement Policy Statement and Expectations for PR19 (May 2016)<sup>119</sup>
- Ofwat's 'Tapped In' report (March 2017)<sup>120</sup>
- UKWIR good practice documents<sup>121</sup>
- The AccountAbility AA1000 Stakeholder Engagement Standard<sup>122</sup>
- CCW Defining and Applying Triangulation in the Water Sector (July 2017)<sup>123</sup>
- Market Research Society good practice<sup>124</sup>

Furthermore, CCGs were actively encouraged by Ofwat to give their own views on engagement and in doing so to apply their own benchmarks.

### Key sources of evidence

In addition to the company's own submissions, there appears to be three key sources of evidence on the quality of engagement for the CMA to consider:

1. Ofwat's own assessments
2. Customer challenge group assessments
3. CCW insights

The views of 1-3 have been outlined in Part 1. In Part 2 we provide our reflections on each in turn.

<sup>118</sup> For example, the following provides an overview of the advantages and disadvantages of the main engagement techniques: <https://www.esan.org.uk/wp-content/uploads/Final-ESAN-event-paper-23-Dec-2016.pdf>

<sup>119</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap\\_pos20160525w2020cust.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap_pos20160525w2020cust.pdf)

<sup>120</sup> <https://www.ofwat.gov.uk/publication/tapped-in-from-passive-customer-to-active-participant/>

<sup>121</sup> UKWIR is responsible for facilitating the shaping of the water industry's research agenda, developing the research programme, procuring and managing the research and disseminating the findings. It has produced a range of engagement related reports.

<sup>122</sup> [https://www.accountability.org/wp-content/uploads/2016/10/AA1000SES\\_2015.pdf](https://www.accountability.org/wp-content/uploads/2016/10/AA1000SES_2015.pdf)

<sup>123</sup> <https://www.ccwater.org.uk/wp-content/uploads/2017/07/Defining-and-applying-triangulation-in-the-water-sector.pdf>

<sup>124</sup> <https://www.mrs.org.uk/>

## Ofwat's own assessments

We consider two main sources of Ofwat's views on companies' engagement:

- Its Initial Assessment of Business Plans (IAP) engagement
- Its response to each of the company's Statements of Case

### Ofwat's Initial Assessment of Business Plans

One of Ofwat's test areas in its Initial Assessment of the Business Plans (IAP) was 'Engaging Customers'<sup>125</sup>. Under the regulator's own assessment all four companies appear to have carried out good research arguably giving greater weight to the customer insights the companies outline<sup>126</sup>:

- Ofwat awarded Anglian Water the only A-rating for the Engaging Customers test area. Bristol Water, Yorkshire and NWL were all among the nine companies that received B-ratings (the remaining seven water companies received a C grade).
- The regulator praised all four companies for their research. In particular, it pulled out as good practice Anglian Water for its "innovative multi-stage willingness to pay research, which was externally assured. Also, it praised its "clear line of sight between what its customers said and the proposals in the business plan" and "its engagement with customers on longer-term issues." This includes "acceptability and valuation research, as well as specific research on resilience and intergenerational fairness"
- It also said for example, that Bristol Water and Yorkshire Water "provide evidence of research methods that are assessed to be high quality". Yorkshire is particularly praised for use of behavioural economics techniques to help customers make more informed choices among other areas.
- Northumbrian Water is said to have sufficient high quality "customer research on asset health and resilience" which were reflected in the business plan, among other areas<sup>127</sup>.

Despite these overall 'quality' ratings, the regulator also flagged shortfalls in the companies' approaches as part of this assessment. Notably:

- Weaknesses in the way Northumbrian Water sourced the marginal benefit values used in calculation of ODI rates<sup>128</sup>;
- Yorkshire Water's "insufficient evidence of customer research underpinning longer term priorities, risk appetites, or the needs of future customers"<sup>129</sup>.
- Limitations in Bristol Water's triangulation approach with a lack of adoption of industry best practice guidance (later challenged with an independent review<sup>130</sup>) and the fact the company conducted customer segmentation to better understand different customer needs and preferences, but gained insight from stakeholder groups rather than primary research with a diverse range of vulnerable customers<sup>131</sup>.

It is worth noting that while the regulator outlined principles for engagement in its Customer engagement policy statement, and published its March 2017 'Tapped In' report on customer participation, we could find little detail on precisely how it assessed this test area. In particular, what research and documents the regulator scrutinised, what its engagement criteria were and how and what weighting it gave to each area. For example, we could not find evidence as to how it weighted innovation and ongoing engagement relative to triangulation or validation of results which

<sup>125</sup> <https://www.ofwat.gov.uk/regulated-companies/price-review/2019-price-review/initial-assessment-of-plans/>

<sup>126</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/01/PR19-initial-assessment-of-plans-Summary-of-test-area-assessment.pdf> p.26

<sup>127</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/01/Northumbrian-Water-Test-area-assessment.pdf> p.1

<sup>128</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/01/Northumbrian-Water-Test-area-assessment.pdf> p.1

<sup>129</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/01/Yorkshire-Water-Test-area-assessment.pdf> p.1

<sup>130</sup> Bristol Water's CCG Chair highlighted that CCW stated that the triangulation complied with their good practice and that Ofwat did not explain why the triangulation was deemed to be poor.

<sup>131</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/01/Bristol-Water-Test-area-assessment.pdf> p.1

would arguably be more relevant for the CMA's review. Nor how it had considered the CCG views. To better understand the value of these grades the CMA may want to request and review in more detail Ofwat's assessment approach for this test criteria.

### **Recommendation**

**In line with regulatory good practice we would encourage Ofwat to publish its *full* criteria and assessment for the engagement test criteria used in its initial assessment of plans so as to provide greater transparency, understanding and confidence in the results. This will also help to inform future engagement practice.**

### **Evaluating Ofwat's approach**

#### **Efficient costs**

In a number of instances the regulator says it is not overriding the views of customers but thinks that the same outcome that consumers want can be delivered for less. In these instances, the argument would seem more about company efficiency rather than engagement and the two things should not be confused.

As Ofwat states: "Broad indications of customer preference obtained as part of the engagement process should serve to shape the company business plans, but they do not relieve the companies of the need to evidence either the need for or the efficiency of their proposed expenditure. Nor does broad customer support immunise the company business cases from appropriate regulator scrutiny and challenge<sup>132</sup>."

Ofwat states "In particular, that customers' stated preferences should not be confused with judgements as to the efficiency or otherwise of companies' proposed plans. Customers both now and in the future are entitled to expect that they should fund only expenditure that is efficiently incurred<sup>133</sup>".

It is reasonable to assume that customers would not want to pay for inefficient costs. In these instances, if Ofwat's assertions are correct, the regulator is acting in accordance with its Engagement Principle 7 outlined in its PR19 methodology - stepping in protect consumers. Indeed qualitative insight from company engagement and wider research<sup>134</sup> indicates some customers are concerned about: unfair prices, value for money, and money going unnecessarily into shareholder pockets; often do not feel qualified to make decisions on efficiency and complex water issues and prefer experts to make these decisions for them<sup>135</sup>; and expect and welcome Ofwat performing this role - thus highlighting its importance.

As Yorkshire Water's engagement appendix captures:

- "Customers were generally satisfied with our services and Performance Commitments (PCs), with all PCs deemed to be relevant without omissions. Many customers trusted us to set sensible targets, while Ofwat's involvement offered further reassurance<sup>136</sup>."

<sup>132</sup> [https://assets.publishing.service.gov.uk/media/5eb15fa7e90e0723b3636e74/001\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Introduction\\_and\\_overall\\_stretch\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb15fa7e90e0723b3636e74/001_-_Reference_of_the_PR19_final_determinations_Introduction_and_overall_stretch_002_.pdf) p.45 Para 3.118

<sup>133</sup> Ibid. p.44 Para 3.117

<sup>134</sup> E.g. Recently published report for the National Infrastructure Commission. <https://www.nic.org.uk/wp-content/uploads/FINAL-Britain-Thinks-Regulation-Resilient-Social-Research.pdf>. See also Citizens Advice's report <https://www.citizensadvice.org.uk/about-us/policy/policy-research-topics/consumer-policy-research/consumer-policy-research/monopoly-money-how-consumers-overpaid-by-billions/>

<sup>135</sup> <https://www.ccwater.org.uk/wp-content/uploads/2020/05/Engaging-water-customers-for-better-consumer-and-business-outcomes.pdf>

<sup>136</sup> <https://www.yorkshirewater.com/media/1962/appendix-5a-customer-and-stakeholder-engagement.pdf> p.56

- “Customers were generally reluctant to select variable improvement levels over time. While most felt confident selecting PCs for improvement, they believed Yorkshire water (and Ofwat) were better placed to make these more nuanced investment decisions<sup>137</sup>.”

On profits, AW’s research appendix states<sup>138</sup>:

- “Across qualitative research and engagement activities customers want more assurance that current levels of profit are ‘fair’ and reasonable (given the need to invest in the infrastructure and tackle future challenges while keeping bills affordable)”.
- Acceptability research on the Strategic Direction Statement, Fair Profits “was ranked 10<sup>th</sup> of the 10 outcomes in order of importance, however it was still seen as important by 67% of customers. (The most important outcome was seen as important by 97% of customers). But that “Customers made a variety of suggestions about how to make the outcomes more acceptable, including achieving a better balance between profit, investment, costs, and customer satisfaction.”
- In the online community trial, customers were clear that they wanted the company to share honest information about costs, investment and profits.

Northumbrian Water’s engagement doesn’t have a specific summary on profits but some of the comments (albeit taken out of context here) captured from wider research hint at similar views:

- Feedback on smart wastewater network stated: “The scheme was typically well received, with flood prevention and improvements to drainage seen as key benefits. However, some customers questioned why the costs should be taken from customers rather than paid for through NWL profits”<sup>139</sup>.
- Resilience: “Customers were asked if they would be willing to pay additional money on their bill to support works to increase the resilience of the water supply to their home and reduce the likelihood of the water supply to their home being cut off during a rare event. At this point the amount that customer bills could increase by was not specified. Customers were not willing to pay more, as it was felt that additional investment should come from NWL profits, and the risk was low or even with additional monies the risk could not be eliminated altogether. Customers were then informed that the proposed amount that their bill would go up by was £2.25 (NW) / £1.29 (ESW). Customers were more likely to be willing to pay on this basis. However, the majority were still reluctant, feeling that NWL should be doing all that they can to reduce the risk of the water supply being cut off and shouldn’t need to seek additional customer monies to do so.”<sup>140</sup>

#### Areas where the regulator has overridden stated consumer research

There are a number of instances where the regulator says it “did override customer research presented by companies” or weighted it differently, particularly in the development of ODIs. Ofwat argues that in many instances this was: to better align the outcome with customers’ interests and preferences “rather than move away from them” including where the company may have ignored or poorly weighted evidence from its own research; because it has concerns about the poor quality or bias of research that underpins a decision; or as the decision is based on additional evidence that was not available to the company’s stakeholders including the CCG<sup>141</sup>.

<sup>137</sup> <https://www.yorkshirewater.com/media/1962/appendix-5a-customer-and-stakeholder-engagement.pdf> p.81

<sup>138</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/pr19-12c-anglian-water-customer-engagement-report-14-Aug-2018.pdf> p.258

<sup>139</sup> [https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated\\_appendix\\_2.2\\_compendium\\_of\\_customer\\_engagement\\_summaries\\_for\\_pr19\\_nwg\\_-\\_resubmission\\_april\\_2019.pdf](https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated_appendix_2.2_compendium_of_customer_engagement_summaries_for_pr19_nwg_-_resubmission_april_2019.pdf) p.179-180

<sup>140</sup> Ibid. p.13

<sup>141</sup> [https://assets.publishing.service.gov.uk/media/5eb1601486650c4358b3cca9/007\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Outcomes\\_-\\_response\\_to\\_common\\_issues\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb1601486650c4358b3cca9/007_-_Reference_of_the_PR19_final_determinations_Outcomes_-_response_to_common_issues_002_.pdf) p.18 Para 5.5



There are other areas though where it says that the decision it made is “in recognition that companies’ customer research can only ever imperfectly capture customers’ actual preferences and even good customer research is at best an estimate of the underlying customer preferences<sup>142</sup>”. It also highlights that all decisions have elements of ‘regulatory discretion’.

Transparency is needed around these ‘discretionary decisions’ especially as arguably Ofwat’s approach has not been subjected to as much scrutiny as the companies. It may be that Ofwat favours a particular methodology, weights customer insight differently, or draws different conclusions from the same evidence base because of the values or assumptions it holds. For example, all four companies undertook and triangulated a range of willingness to pay research, some of which Ofwat and their CCGs recognised as good practice. In some of the arguments put forward by Ofwat in relation to the ODIs it seems that the focus is less on the quality of the research and more about the triangulation process and application of the companies’ engagement findings.

#### Understanding need

In at least one important instance, Ofwat appears to challenge the *need* for a company proposal (NWL’s Abberton-Hanningfield raw water transfer scheme in Essex) rather than the high level of customer support for it. NWL argues that the strength of consumer views towards longer-term resilience investment and the value that customers put on this, is not reflected in the regulator’s assessment of need and should be. How the regulator assesses ‘need’ (the trade-offs it makes between short and longer-term, social, environmental factors) and in particular how it reflects customer views and public interest needs (or if this is an economic assessment only) also warrants further scrutiny and transparency.

#### Demonstrating consideration of consumer and wider public interest value

The Gray report in 2011 highlighted that “On the question of whose views should prevail, the final decision, at least in terms of the price reviews, must be for Ofwat, but Ofwat should be careful about substituting its own views for those expressed by or through the consumer representative”<sup>143</sup>. In addition, Sustainability First’s collaborative Fair for the Future project<sup>144</sup> has identified, future consumer, mutual/societal, community and local interests are not always getting the attention they need in regulatory decision making<sup>145</sup>.

Given this context and the concerns raised by companies and CCGs about Ofwat not giving due weight to customer views, we would encourage the CMA to consider if Ofwat has fully considered not just the consumer benefits but the wider societal value of proposals in making its decisions. As part of its assessment the CMA might explore alternative methodologies such as Social Return on Investment evaluations<sup>146</sup> or wellbeing analysis as is outlined in the recently updated Treasury Green book<sup>147</sup>. Such methods are increasingly being used. For example, all of the gas distribution network companies have employed some form of social value accounting in response to Ofgem’s request that they demonstrate the wider value that their business plan proposals will deliver for consumers and society.

Such approaches are arguably increasingly relevant given the importance of the net-zero agenda and social challenges presented by the Covid-19 pandemic. Furthermore, given the well-recognised

<sup>142</sup> Ibid. p.18 Para 5.7

<sup>143</sup> <https://www.gov.uk/government/publications/review-of-ofwat-and-consumer-representation-in-the-water-sector> p.78

<sup>144</sup> Note this project is sponsored by a wide range of utilities, including Anglian Water

<sup>145</sup> <https://www.sustainabilityfirst.org.uk/fair-for-the-future> -

[https://www.sustainabilityfirst.org.uk/images/publications/fair\\_for\\_the\\_future/SF\\_F4TF\\_Consumer\\_Lived\\_Experience\\_Working\\_Note\\_Oct\\_19.pdf](https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/SF_F4TF_Consumer_Lived_Experience_Working_Note_Oct_19.pdf)

<sup>146</sup> SROI assigns a quantifiable value to the positive outcomes enjoyed by society – ultimately establishing a value of a proposal to society. Outcomes could include financial, environmental, health or customer utility benefits.

<sup>147</sup> <https://whatworkswellbeing.org/blog/treasury-green-book-and-wellbeing-the-analysis/>

limitations of willingness to pay approaches. Furthermore, as CCW's research suggests that complex surveys such as WTP where respondents are required to assimilate large amounts of information are among the least appropriate areas for customer research<sup>148</sup>.

### **Recommendation**

**Given stakeholder concerns about the weighting of consumer views in the regulator's assessments, the CMA may want to explore using alternative evaluation methodologies to cross reference its approach such as Social Return on Investment approaches, or wellbeing analysis as is outlined in the updated Treasury Green book to ensure the wider public interest is captured.**

### Balancing current, changing and future consumer needs

Ofwat's 'Customer Engagement Policy Statement and Expectations for PR19' (May 2016) outlines a "long-term vision to put current and future customers at the heart of the way companies run their businesses". This is seen as integral to the delivery of the regulator's overall aim that "Customers and wider society have trust and confidence in vital public water and wastewater services"<sup>149</sup>.

The regulator puts a strong focus on future consumers in its customer engagement policy statement. Indeed, it states: "good quality customer engagement will involve informing and engaging customers on longer-term issues. Resilience, security of services and long-term affordability of bills are examples of longer-term issues that matter to customers and society."<sup>150</sup>

The Sustainability First 'Fair for the Future' project also highlights that a shift is required in regulatory decision-making from focusing primarily on transactional activity and short-term results to also considering the wider 'consumer lived experience' which is cumulative and builds up over time, and can be both individual and collective – blurring consumer and citizen boundaries.<sup>151</sup> Getting the right framing and balance is needed to address environmental and climate issues and to keep individual and system costs down. The CMA may therefore want to particularly explore how Ofwat has approached intergenerational issues.

This is especially the case given the customer evidence backed by CCW and the CCGs that many customers prefer to pay a little more today towards resilience, rather than receive further bill cuts and deferring investment for future generations to pay. We encourage the CMA to ensure it is transparent in how it is balancing the needs of current and future consumers and to strongly consider the outcomes consumers desire, short and long-term.

### Reflecting regional differences

We did not look in detail at the regional differences in engagement findings as part of this review but highlight this as a potential area for further consideration.

One of the expected benefits of companies being responsible for their own engagement and the CCG framework, was that water companies could better reflect the needs, wants, and preferences of their own regions – recognising the cultural, economic, social and attitudinal differences. Indeed, recognising and responding to regional difference is arguably seen as increasingly important. The Government's 'levelling-up' agenda and Industrial Strategy has a major focus on regional growth. And the desire for 'equitable decentralisation' is a significant part of the Labour Party's

<sup>148</sup> <https://www.ccwater.org.uk/wp-content/uploads/2020/05/Engaging-water-customers-for-better-consumer-and-business-outcomes.pdf> p.5

<sup>149</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap\\_pos20160525w2020cust.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap_pos20160525w2020cust.pdf) p.3

<sup>150</sup> Ibid. p.19 Para 3.1.5

<sup>151</sup> [https://www.sustainabilityfirst.org.uk/images/publications/fair\\_for\\_the\\_future/SF\\_F4TF\\_Consumer\\_Lived\\_Experience\\_Working\\_Note\\_Oct\\_19.pdf](https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/SF_F4TF_Consumer_Lived_Experience_Working_Note_Oct_19.pdf)

thinking on the nationalisation of energy networks<sup>152</sup>. Technological, political, and environmental changes are also making local and community approaches (such as catchment management schemes) and co-delivery with communities more prevalent. Covid-19 is also accentuating local differences.

The water companies operate in different contexts, with different local challenges and cultures, different ownership models, performance histories and relationships with their customers, with some more trusted than others. Bespoke performance commitments are one mechanism that allows companies to reflect these differences.

The regulator argues it considered regional differences in some areas. For example, it states: “there were a few reasons why customers should receive a different level of service in different regions (for example supply interruptions, pollution incidents and internal sewer flooding).<sup>153</sup>” However, further probing of its approach to evaluating and valuing regional differences in views may be particularly useful.

Some regional differences are well recognised e.g. differences in willingness to pay for social schemes, but the research insight from companies synthesis reports also indicates there may be wider variations in attitudes which arguably should be considered when both assessing research and making decisions. For example, different attitudes towards rewards and penalties for companies; towards investment in the future and towards the environment and resilience.

We are mindful that the lack of comparability of research may make it harder for the regulator to unpick variations. We would nonetheless encourage greater transparency in the overall approach Ofwat has taken.

The CMA may want to explore how Ofwat has identified, valued and reflected any regional differences in consumer views. It would be useful to explain publicly how regional variations in consumer and community needs, wants and priorities are reflected in any final decision.

### Recommendation

**The CMA may want to particularly explore how certain kinds of Ofwat’s ‘discretionary’ decisions have been made. Greater transparency around the values, assumptions, methodologies and wider approaches informing any evaluations would be useful. In particular: how Ofwat has defined and valued ‘consumer’ needs and preferences; how the requirements of current and future consumers have been balanced; and regional variations in views.**

### Transparency and legitimacy

As noted, transparency around how these ‘discretionary decisions’ are made is important. Key stakeholders want to understand what values and principles are driving decisions, and what trade-offs have been made. Ofwat has required companies to demonstrate their ‘golden thread’ between customer views and its final decisions. In line with regulatory good practice, Ofwat arguably needs to do the same. For example, in the case of Bristol Water, how did Ofwat go about understanding the value to customers of being supplied by a local water company? Did it use revealed preference which looked at the premium customers pay for local produce, or for being supplied by a council run energy company?

<sup>152</sup> <https://www.labour.org.uk/wp-content/uploads/2019/03/Bringing-Energy-Home-2019.pdf>

<sup>153</sup> [https://assets.publishing.service.gov.uk/media/5eb1601486650c4358b3cca9/007\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Outcomes\\_-\\_response\\_to\\_common\\_issues\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb1601486650c4358b3cca9/007_-_Reference_of_the_PR19_final_determinations_Outcomes_-_response_to_common_issues_002_.pdf) p.19 Para 5.12

Ofwat's lack of customer engagement to inform its PR19 methodology is a clear weakness and may have undermined its legitimacy. We welcome therefore that in its October 2019 Strategy the regulator has promised to "listen more directly to better test our policies and guide where and when we hold companies to account<sup>154</sup>".

It is also worth noting that Ofwat do not seem to have explained in detail, prior to its response to the companies Statement of Case, precisely how it valued and used customer insights or the CCG reports. This may have added to the concerns of some CCGs and wider stakeholders regarding *if* and *how* Ofwat considered customer and stakeholder views in its final decisions.

As NWL says in its Statement of Case: "Ofwat has suggested that customer support on its own cannot be enough evidence for it to support different aspects of the business plan. While it seems intuitively reasonable for Ofwat to seek a range of evidence to support its decisions as an independent regulator, the reality of the PR19 process has been that Ofwat has placed much greater emphasis on all other forms of evidence, including benchmarking evidence across company submissions. This has delivered a result where it has been difficult to identify where in the settlement customer evidence has directly influenced FD19."<sup>155</sup>

### Recommendation

**The CMA is encouraged to explain for each company business plan how it has considered customer and stakeholder views and to provide a clear line of sight between the outcomes customers say they want and the final determination. Greater transparency in this area would be welcome. This will be important for trust and legitimacy.**

## Weighting CCGs' views

As noted, Ofwat set an expectation that all companies would have a customer challenge group (CCG). Their primary role was to provide independent challenge to companies and independent assurance to the regulator on the quality of a company's customer engagement and the degree to which this is reflected in its business plan. The groups are not expected to endorse a company's overall business plan, nor did the regulator expect them to act as a substitute for the views of customers.

The CCGs are seemingly not only designed to, but well placed to give a view on the quality of the company's engagement and stakeholder and customer views. They have a relatively long-term view of the company's activity, with some CCGs having been in operation since the last price control.

Given that they are 'based' within the company but separate from it, CCGs can have a useful perspective on company culture and engagement in practice. Most also have members with local knowledge and understanding who are plugged into relevant communities and can give a grassroots perspective.

However, in its initial assessment of plans Ofwat flagged concerns about "inconsistency in how independent and transparent CCGs are and how much they challenged the companies<sup>156</sup>" - though recognising that all CCGs help companies improve the overall quality of their customer engagement and how much customers' preferences are reflected in the business plan. Ofwat raised this concern again in its response to company Statement of Cases seemingly undermining the weight given to

<sup>154</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/10/Time-to-act-together-Ofwats-strategy-1.pdf> p.12

<sup>155</sup> [https://assets.publishing.service.gov.uk/media/5e8dc5f886650c18d05f7f30/NWL\\_PR19\\_Statement\\_of\\_Case\\_2.4.2020\\_PDF.pdf](https://assets.publishing.service.gov.uk/media/5e8dc5f886650c18d05f7f30/NWL_PR19_Statement_of_Case_2.4.2020_PDF.pdf) p.53 Para 241

<sup>156</sup> <https://www.ofwat.gov.uk/publication/pr19-initial-assessment-of-plans-summary-of-test-area-assessment/> p.29

customer challenge group views: “We are currently considering the future role of CCGs (or equivalent) for PR24, including how to better promote the independence of the CCGs from companies.”<sup>157</sup>

The Anglian, Northumbrian/Essex and Suffolk and Yorkshire CCGs have strongly refuted any suggestion of ‘capture’, saying independent challenge is integral to their work.

### Questions to ask CCGs

Based on our review of information in the public domain (CCG reports and websites) and our discussions with CCG Chairs (excluding Bristol Water’s CCG), we found that there were significant differences in:

1. The breadth and depth of CCG challenge on engagement
2. How CCGs assessed and evaluated engagement
3. Membership, including expertise on the groups
4. The transparency and reporting of activity
5. Governance arrangements in place in order to ensure and demonstrate independence

Some CCGs, such as Yorkshire Water’s, have also adopted a broader or different role and scope than the one Ofwat requested.

In order that the CMA might better understand and have confidence in the robustness of the views presented by different CCGs, we have outlined below a series of questions it might ask CCGs or consider. It is worth noting that not all information may be in the public domain so a discussion with the CCG is necessary.

### The depth and breadth of challenge

Ofwat requested that groups give ‘independent assurance’ to the regulator but only provided limited guidance on how this might be done. It did not specify the depth of scrutiny that should be undertaken by the CCG, and different groups therefore had different approaches, in part dictated by the resources available to them and the vision of the Chair.

Ofwat also did not specify how the CCGs should operate. Across the sector CCGs outline different ways of working with some more collaborative than others. For example, a CCG such as Affinity Water said they acted as ‘armchair auditors’<sup>158</sup>, others like Anglian Water’s Customer Forum<sup>159</sup> had members of its group sit on the company’s engagement steering group to in their words “help guide and co-create the company’s customer engagement strategy from the outset” and so that the company’s engagement strategy could be examined in more detail.<sup>160</sup>

The CCGs scrutinise engagement and research in many different ways. These include but are not limited to:

- *Overall engagement strategy* – e.g. helping to shape the overall engagement plan, selection of the right research methods, target audiences, the right questions to ask. Some groups actively collaborate with the company to “co-create” the strategy. This has the advantage of them having more impact on the approach and being closer to the detail but requires greater safeguards around independence<sup>161</sup>.

<sup>157</sup> This was included in Ofwat’s response to three of the four water companies’ Statement of Cases but not Bristol Water’s.

<sup>158</sup> <http://r.aw.switch-dev.co.uk/docs/CCG/CCG-Business-Plan-Report.pdf> p.47

<sup>159</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/anh-customer-engagement-pr19-report.pdf> p.4

<sup>160</sup> Three members of the CEF sat on Anglian Water’s Customer Engagement Steering Committee (CESG) to in the CEF’s words “help guide and co-create the company’s customer engagement strategy from the outset” and so that the company’s engagement strategy could be examined in more detail. Given Anglian’s A-rating for engagement in Ofwat’s IAP this was arguably an effective approach.

<sup>161</sup> In response to Sustainability First’s question to the Chair of Anglian Water’s CCG as to how the Forum could independently assess the strategy it was involved in developing, Jeff Halliwell, the then Chair, said that independence was safeguarded by: the individuals selected –

- *Research design* – e.g. reviewing surveys to ensure questions aren't leading, scrutinising the framing of research to ensure information is easy to understand or that comparative information is provided or balanced; a focus on samples being robust and representative including harder to reach groups. CCGs do this to varying degrees.
- *Observation of engagement* – all groups appear to have observed engagement in practice but to very different extents. This is an important way to get behind any research company or water company sales pitch and to see if engagement delivers on its aims. It can be useful to hear customer views first-hand (though these will not necessarily be representative). In the case of cognitive testing for key pieces of research such as acceptability testing and willingness to pay, it can highlight areas that customers struggle to understand, and help to interpret the results in a meaningful way.
- *Reporting of conclusions* – CCGs can review and check research reports and subsequent insight appendices to ensure the findings are accurately reported and complete. This can prevent selective reporting by the company.
- *Application and use of findings to decision making* – Most CCGs seemed to review *how* and *if* results were triangulated with wider research. Scrutiny of the application of WTP values is less clear. For example, whether WTP makes a telling difference depends on (i) whether the survey outcomes have been applied and used properly in calculating a CBA and (ii) whether that CBA has then made a difference either because it has affected an investment decision at the margin or because it is the sole or main rationale for proposing an investment. There appear to be different levels of scrutiny and expertise at this stage across the four CCGs<sup>162</sup> and different levels of challenge on the ODIs.

For any given piece of work, the CCG may have conducted all or none of these assessments. For key pieces of work on which contentious company or Ofwat decisions are based, it may be useful to understand the scope and level of scrutiny undertaken by the CCG.

The following questions will give an indication of the breadth and depth of scrutiny undertaken by the CCG:

- Which research did the CCG review and what level of scrutiny (as per above) did it undertake on each of these?
- What challenge did the CCG give on any area of CMA focus?
- How much time did the CCG spend scrutinising research e.g. days, weeks, hours?
- Does the CCG have a dedicated engagement or research subgroup and how often did it meet?
- What challenge did the CCG give the company? This should to be documented in the CCG reports/appendices and in particular its challenge log and minutes.

#### CCG expertise and access to information

A key learning from the PR14 engagement process was that the regulator could be more confident in a CCG and the views it expresses when: “the report relates to an area of expertise for the CCG and/or when the CCG includes expert members. For example, the views of a debt charity on the company’s approach to affordability<sup>163</sup>”. However, the regulator did not specify the core skills that the CCGs needed within their membership. This is perhaps a lesson learned (see footnote 142).

who included members of the independent statutory watchdog CCW, and professionals with their reputations to protect; and the structure and organisation of the CEF’s activities that held each other to account. In addition, he used a teacher analogy: “our role is to mark the company’s homework. Not to write it. But like any good teacher, we may suggest that the pupil reads a certain text book or approaches the structure of the essay in a certain way. But if the essay is no good, that is the pupil’s responsibility and we will mark it accordingly.”

<sup>162</sup> Anglian Water’s CCG set up an ‘Economics and Valuation Sub-Group’ comprising three independent economic regulation experts but information in the public domain suggests that expertise in this area is not as strong across all CCGs.

<sup>163</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2018/03/Aide-Memoire-for-Customer-Challenge-Groups.pdf> p.6

The membership and size of the CCGs varies. Ideally all CCGs have members with a wide range of relevant knowledge and experience and a diversity of perspectives. In practice, this may not always be possible especially where members are not paid. Those with full time jobs for example, may not always be available to dedicate the time, at the right time, to what is a demanding role.

It is important when considering a CCG's views that the CMA assesses if the group has/had appropriate expertise and information to give a fully informed view on any topic of relevance. Not all of the four CCGs for example appear to have research methodology, willingness to pay/validation experts or economists. In the case of the latter, unless an independent review is commissioned, it may limit the group's ability to scrutinise how the company is interpreting and applying the values it gets from some of the quantitative research.

It is also worth noting that while Ofwat produced an Aide Memoir<sup>164</sup> summarising the areas that it expected the CCGs to scrutinise, it did not give a view on how companies should balance and weight the views of current and future consumers. In addition, while it commissioned its Tapped-In report on consumer engagement, due to competition constraints there was only limited sharing of engagement approaches between CCGs and there was no consistent way to benchmark engagement approaches.

Questions to consider:

- What is the expertise of the CCG's membership?
- What does the CCG say it *is* and *is not* able to realistically take an informed view on given the scrutiny it undertook, the information it had available and the expertise on the group?

#### Governance approach including ensuring independence

Working in part with the company yet needing to remain at arms-length is part of the CCG process. It is particularly important therefore that the CCGs ward against capture and can demonstrate their independence.

In its Customer Engagement Policy Statement Ofwat states that there are two main factors that it will consider when taking into account the CCG reports at PR19:

- The evidence provided in the CCG report demonstrating how the CCG has carried out its role
- The strength and transparency of the governance arrangements in place.

In particular, Ofwat states "to build trust and confidence with customers and other stakeholders, we have said we would like to see an increased focus on CCG governance and funding process transparency in PR19".<sup>165</sup>

All four CCG assurance reports to Ofwat are highly positive of their respective water company. It should be noted that this is not in itself an indication of capture. A well-established effective CCG scrutinising a water company that is open to challenge may have resolved a number of disagreements by the end of the process when the CCG report is submitted (though you would expect to see some evidence of outstanding disagreements). In considering independence, it is particularly important therefore for the CMA to understand what challenges were made along the way. Most CCGs have a challenge log, minutes and other documentation that evidences the level of challenge and the issues they raised.

The regulator outlined examples of good practice governance in its CCG Aide Memoire and CCGs have put safeguards in place to varying degrees. These include but are not limited to:

<sup>164</sup> Ibid.

<sup>165</sup> Ibid. p.3

- Recruitment of Chair and members via open competition/with independent consumer representation e.g. CCW on the recruitment panel<sup>166</sup>
- Member/chair tenures which get the right balance between continuity of expertise and fresh independent perspectives
- Holding private sessions when company representatives are not present
- The CCG controlling the agenda and company members only attending by invitation
- Having a declarations of interest policy and register of interests
- Transparency and accountability around how the CCG operates

Suggested question:

- What good practice governance arrangements does the CCG have in place to ensure and demonstrate independence?

### **Recommendation**

**We support Ofwat undertaking a strategic review of its approach to engagement including: asking what problem engagement is there to solve; what ‘opportunities’ engagement can help unlock; the respective roles of regulatory-led, provider-led and other engagement activity; and what the future role of CCGs might be within this broader picture. There are clearly lessons learned for all parties – Ofwat, companies and the CCGs. It will be important for the regulator to build on the success of the approach and not ‘throw the baby out with the bathwater’ given differences of views between the CCGs and the regulator.**

**Please note:** Sustainability First will be publishing a cross-sector ‘lessons learned’ document and think piece on the future consumer engagement in the utilities sector later this year. For a copy please email [zoe.mcleod@sustainabilityfirst.org.uk](mailto:zoe.mcleod@sustainabilityfirst.org.uk)

## **Reflections on CCW’s evidence**

Representatives from CCW sat on the CCGs and a number of companies involved or consulted CCW head office engagement experts in the design of their research. The statutory watchdog also has significant sector expertise, has conducted its own research, has its own monitoring data, and has a useful comparative view across the different companies.

Both Ofwat and CCW cite CCW’s draft determination acceptability research. We are not aware of any independent assurance around this research. However, CCW states that “DJS Research carried a pilot survey which included cognitive testing to ensure research materials were understandable for participants before the full survey took place. This led to a few changes to the survey design”<sup>167</sup>. The robustness of the approach may be worth clarifying. In addition, we note CCW’s views on customer attitudes towards incentives may not align with some of the water company research which is recognised by CCGs. For example, BWCP said “The engagement [Bristol Water’s engagement with customers] showed that participants were generally comfortable with the principle of incentives. Financial incentives were generally preferred.<sup>168</sup>” This appears to be at odds with CCW’s view. In addition, we are unclear if there is any consumer evidence that underpins CCW’s position on the Small Company Premium.

<sup>166</sup> Other regulators have been more involved in the selection of chairs to ensure independent. For example, as part of Ofgem’s enhanced engagement process the regulator had a veto on choice of RIIO-2 Chairs (a veto which they used) and the Civil Aviation Authority were directly part of the recruitment panel for the Heathrow Consumer Challenge Board Chair. Ofwat could consider something similar to ensure independence.

<sup>167</sup> By email 22/06/2020

<sup>168</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2018/09/BWCP-Assurance-Report.pdf> p.59 Para 12.5



## Other issues worth noting

### Companies use of co-creation/local schemes

All four water companies say they have ‘co-created’ parts of their business plans. In essence, co-creation is an approach that brings together different relevant parties (the company, customers/users, citizens, communities, employees, experts) in collaborative engagement to produce a mutually valued outcome.

‘Traditional engagement’ approaches tend to be highly company-led and controlled:

- The company identifies their aims, a problem, or issue.
- The company then develops a range of solutions, products, services to address the problem, meet their aims or address issues.
- The company then consults or engages with customers or community groups on their preferred approach/es to the above. Customers may give their views on a limited number of options proposed by the Company.
- In some instances there may be some scope for customers or community groups to submit ideas, but ultimately it tends to be a company-led design and selection process with the company setting fixed parameters for contributions made, and making the final decision.

Co-creation is more *collaborative* at every stage of the company’s decision-making process than traditional company engagement approaches. The company (if they genuinely have co-created) tends to have less direct control over the process. A key factor is that all parties involved, including importantly customers and citizens play an *active* part in not only identifying what is important to focus on, but also in the creation of approaches, solutions to problems and, products and services that they value (‘the how’). It is more bottom-up than top down from the company.

Ofwat’s ‘Tapped In: From passive customer to active participant’ report<sup>169</sup> actively encouraged companies to work collaboratively with customers and communities in their business plan development. The stated benefits included:

- A feeling of shared ownership in local communities
- Increased understanding of the importance of water
- Peer group persuasion

Prerequisites for effective engagement include people who are engaging having ‘a belief in the value of community participation’ and companies having ‘the skills in how to catalyse local community ownership and participation’<sup>170</sup>.

In these cases, where customers have invested their time in working with the company to develop an approach, have a sense of ownership over it, and an expectation that a proposal will be delivered there could be greater sensitivities if this is not delivered. For example, more impacts for trust and legitimacy for the company, Ofwat and the CMA and potentially less willingness to engage and collaborate in the future. This can also be the case for local resilience schemes such as those proposed by Northumbrian Water, where issues may be particularly hotly debated and views strongly held.

<sup>169</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2017/03/1941\\_OFWAT\\_Cust\\_Participation\\_Report\\_final.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2017/03/1941_OFWAT_Cust_Participation_Report_final.pdf). This is based on Pathways Through Participation: What Creates and Sustains Active Citizenship

<sup>170</sup> Ibid. p.28

This is especially important given Ofwat's October 2019 Strategy states "Companies will need to have a more meaningful, trusted relationship with customers and communities<sup>171</sup>".

### **Recommendation**

**The CMA may want to be particularly mindful of the views of customers and stakeholders where the company has genuinely co-created an approach and worked collaboratively with the community to develop solutions as this could impact on trust and legitimacy of water companies and regulators. This may be especially the case for local schemes, where engagement could have been extensive, sensitive, and public views strongly held.**

### **Engaging consumers on financing issues**

The review indicates that engaging customers on financing issues can be challenging. Some customers are actively interested in profit levels, dividends and tax; others find it interesting when introduced to it; while some groups including perhaps more younger people, are not interested in this information at all.

For example, Northumbrian Water's 'Our Finances Explained' research involved customers being taken through an introductory overview presentation on the financing and funding of NWL on the following topics: revenue generated from customer bills; capital investment; debt markets and borrowing; interest; taxation; profit; reinvestment and shareholder dividends. It concluded: "Overall, customers expressed positive views about the information presented, with many finding it interesting to learn of the funding and financing of NWL. Customers noted that this is information they would not have proactively sought out prior to attending the workshop, and felt this wasn't something they had previously paid any interest in.<sup>172</sup>"

The difficulties of engaging customers on a discussion about fair returns are highlighted in a number of companies' research insight reports. For example: Anglian Water states in its synthesised insights on customers attitudes to fair profits – which focussed on ownership and management of the company, transparency, profits, debt and tax: "It seems to have been particularly challenging to engage customers on the outcome on Fair Profits, possibly because levels of customer understanding in this area are relatively low. That said, participants at three of the future customer workshops seemed to have been interested in this topic. At one of the workshops, of the six major challenges facing the company, market structures and financing of the industry generated the most questions from those who took part<sup>173</sup>."

Similarly, Northumbrian Water (2017) in its 'Our Finances Explained' research found<sup>174</sup>:

- "A majority demonstrated low awareness that debt was something which is involved in NWL's financial operations.
- Customers were confused to learn NWL made a profit, yet were still borrowing money, with a widely held perception that profit negates the need to borrow money amongst customers".
- Customers were unsure about information relating to long term capital investments whilst knowing that the organisation is continually in debt and borrowing money to enable this.

<sup>171</sup> <https://www.ofwat.gov.uk/wp-content/uploads/2019/10/Time-to-act-together-Ofwats-strategy-1.pdf> p.12

<sup>172</sup> [https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated\\_appendix\\_2.2\\_compendium\\_of\\_customer\\_engagement\\_summaries\\_for\\_pr19\\_nwg\\_-\\_resubmission\\_april\\_2019.pdf](https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated_appendix_2.2_compendium_of_customer_engagement_summaries_for_pr19_nwg_-_resubmission_april_2019.pdf) p.72

<sup>173</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/pr19-12c-anglian-water-customer-engagement-report-14-Aug-2018.pdf> p. 258

<sup>174</sup> Customers were shown a graph where 11p from the £1.07 per day bill was designated as net profit 'including the money that we return to people who have invested in us'. [https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated\\_appendix\\_2.2\\_compendium\\_of\\_customer\\_engagement\\_summaries\\_for\\_pr19\\_nwg\\_-\\_resubmission\\_april\\_2019.pdf](https://www.nwg.co.uk/globalassets/corporate/about-us-pdfs/updated_appendix_2.2_compendium_of_customer_engagement_summaries_for_pr19_nwg_-_resubmission_april_2019.pdf) p.72

CCW also believes that engaging customers on cost of capital and fair returns is hard to do and particular care must be taken not to lead customers<sup>175</sup>.

Jim Dixon, the NWL Forum Chair said “unpicking profit margins, and the cost of capital” was “far too complicated to ask most people” and Yorkshire Forum’s Chair explained that “issues like fair rate of returns and cost of capital were too complex to work through in the kind of consumer research that was undertaken”.

Bristol Water however undertook a full day deliberative session on financing and bill impacts, including developing a finance game. While this reportedly had little focus on profits they said that this approach coupled with carefully developed stimulus materials” allowed them to “have meaningful conversations with customers about a highly technical topic.”<sup>176</sup>

We are not aware that any water company has attempted engaging customers on profit levels or ‘fair returns’ using well-considered deliberative research, with appropriate framing and time allocated; nor evidence of any meaningful engagement on this issue or the cost of capital with expert independent stakeholders beyond the CCGs and CCW.

Calculating the cost of capital is an established regulatory mechanism and we query in practice the scope for public engagement to influence at a company level. However, as part of its RIIO-2 price control determination Ofgem organised a call for evidence on the gas distribution companies business plans. Following submissions about the cost of capital, it intended to hold an open hearing session later this year on this issue (though this may not happen due to Covid-19). This could elicit wider stakeholder views.

It is clear from the insight appendices and wider research that many customers are interested in wider company financing, and while they might not be best placed to give views on the cost of capital, would likely have views on overall profit levels, level of dividends and executive remuneration if they were able to have an informed discussion. Fair returns are arguably intrinsically linked to consumer trust and confidence in the water sector. If customer research in this area were attempted this is seemingly best organised centrally given the relatively high cost of in-depth deliberative research (which this would require).

Regulators, CCW or Citizens Advice might consider leading research in this area to inform price control decisions including deliberative research. This would ensure comparability of views across regions, be more cost effective and help to safeguard impartiality. It could also add legitimacy to any decisions made in this area.

CCW supports customer research in this area. Despite the challenges, it believes that customers should still be engaged on financing issues, and highlights that it has recently used its customer panel to research customer views on profits and outperformance as part of its annual independent analysis of company financial performance<sup>177</sup>.

<sup>175</sup> By email 3/06/2020

<sup>176</sup> <https://www.bristolwater.co.uk/wp-content/uploads/2018/09/Section-C1-Engagement-Communication-and-Research-1.pdf> p.32

<sup>177</sup> <https://www.ccwater.org.uk/research/water-companies-financial-performance-report-2018-19/> The results of the company research are indicative only given the audience size, and will be published in summer 2020

### Recommendation

It is clear that many customers (though not all) are interested in profit levels, dividends and executive remuneration. If this research is conducted, it would be best done centrally by an independent party to ensure comparability of results, impartiality and cost efficiency. If there is sufficient time the CMA might consider this to inform its decision. More generally, regulators, Citizens Advice or CCW could consider leading engagement in this area to inform price control decisions, including deliberative research to help build understanding and trust in decisions.

### **Qualitative insights – understanding what drives customer decisions/values**

There is a tendency in evaluating research to focus on quantitative research over more qualitative insights. However, qualitative research, especially that which sits behind companies' large quantitative surveys can provide useful understanding of the *values* and *assumptions* that are driving consumer views. Understanding and being aware of these drivers may not only help to inform the CMA's evaluation of research and but could also help ensure its final determination is in line with 'the spirit' of what customers really want to see (even if the end proposals are slightly different to those consulted on). For example:

- In the case of specific resilience schemes, understanding the assumptions customers made (and the options presented to them) is particularly important. i.e. had customers thought the Abberton-Hanningfield raw water transfer scheme in Essex might not have been needed in the first place, this could have influenced their overall support for the proposal. Drilling into the framing of engagement on this proposal may be particularly valuable.
- A number of companies report that customers prefer flat bills. This seems primarily driven by a desire for customers to have greater *budgeting certainty and simplicity*, particularly for those on low incomes. This alongside *inter-generational fairness*. E.g. as NWL explains: "Our customers told us that they had a preference for stable and manageable bills over time, because many customers on low incomes cannot absorb unexpected price changes. This *translated* into a preference for flat bills rather than significant decreases in bills in one cycle only to be followed by a rise in following periods. That preference for stable bills is reflected in our BP19.<sup>178</sup>" On customer bills, Ofwat states "We did not have an end position in mind when we applied our PR19 methodology, and our approach to setting bills was from the bottom up, for each of the individual blocks of prices<sup>179</sup>." The actual price aside, given the strong customer preference for stable bills, it could be argued that the regulator should consider how it can ensure that this outcome can be delivered for customers.
- In terms of the acceptability of the cost of bills. Northumbrian Water's research also suggests that customers did not expect a bill reduction of the magnitude of 15% that was proposed in the business plan. As the CCG says "We saw from the info presented to us a majority of those surveyed would have accepted a 10% bill reduction. But, in acceptability testing 'Customers who accepted the plan stated that improved service levels and a reduced bill were intrinsic to acceptance'. They wanted both.<sup>180</sup>" It will be important for the CMA to be confident for all relevant companies that customers opt for relatively higher bill levels because they believe in investing for the future rather than because they think bill

<sup>178</sup>[https://assets.publishing.service.gov.uk/media/5e8dc5f886650c18d05f7f30/NWL\\_PR19\\_Statement\\_of\\_Case\\_2.4.2020\\_PDF.pdf](https://assets.publishing.service.gov.uk/media/5e8dc5f886650c18d05f7f30/NWL_PR19_Statement_of_Case_2.4.2020_PDF.pdf) p.38  
Para 4.1

<sup>179</sup> [https://assets.publishing.service.gov.uk/media/5eb15ef8d3bf7f65241db096/004\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Response\\_to\\_Northumbrian\\_Water\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb15ef8d3bf7f65241db096/004_-_Reference_of_the_PR19_final_determinations_Response_to_Northumbrian_Water_002_.pdf) p.23

<sup>180</sup>[https://assets.publishing.service.gov.uk/media/5ebebda686650c27984d2b9b/Northumbrian\\_and\\_Essex\\_and\\_Suffolk\\_Water\\_Forum.pdf](https://assets.publishing.service.gov.uk/media/5ebebda686650c27984d2b9b/Northumbrian_and_Essex_and_Suffolk_Water_Forum.pdf)

reductions are ‘too good to be true’ and/or that if they support a cheaper bill there would inevitably be service reductions.

- It is reasonable to assume that had customers thought that their respective companies were proposing a higher than needed bill (as Ofwat suggests) that their willingness to pay, acceptability levels, and sense of affordability (which is often linked to perceptions of value for money) of the Plans would have declined. Indeed, as AW’s engagement appendix states: “Quotes set out in the report of the third wave acceptability research suggest that factors driving acceptability include: trust in Anglian Water; a perception that the company has identified the right issues to focus on; and a sense that Anglian Water is aiming for excellence or “setting the bar high”. Quotes suggest that drivers of unacceptability include: costs; a perception that Anglian Water should have invested more and taken less as profit in the past; a concern that future bill increases will support profit not improvement; and a sense that the company is being very ambitious and may not have the resources to achieve it all<sup>181</sup>.
- Acceptability research in particular can identify key consumer drivers for decisions that need to be considered in any final determination.

More widely, as there is increasing technological, climatic and societal disruption more adaptive regulation will be needed. Understanding consumer and community values can help ensure the right outcomes are still delivered, even if the pathway and mechanisms to deliver them need to change with changing circumstances.

As Fair for the Future states: “In a world where disruption and plurality are becoming the new normal, policy makers, regulators and companies need to take a more people-centred approach to better understand how public expectations are changing and ensure decisions take account of how consumers and communities see and value outcomes on the ground. Flexibility is important here; to enable multi-party and cross-sector solutions to come forward and to help secure the delivery of co-benefits.”<sup>182</sup>

### **Recommendation**

**There is a general consensus that customer engagement has significantly shaped all of the company business plans, making them better aligned to customer and stakeholder views. We’d encourage the CMA to be mindful of: the outcomes consumers say they want; their values; and preferences for proposals and bespoke performance commitments, in making its final determination.**

### **Outcomes, performance commitments and Incentives**

In developing their business plan water companies have to state what outcomes they will deliver for customers. Under each key outcome is usually a *measure* of success e.g. number of supply interruptions; and a *performance commitment*’ (PC) e.g. the target that the company says it will reach. Fifteen performance commitments are common to all water and sewerage companies. In addition to these, companies are encouraged with their customers and stakeholders, to develop their own PCs to reflect local preferences. These are called ‘bespoke’ PCs.

<sup>181</sup> <https://www.anglianwater.co.uk/siteassets/household/about-us/pr19-12c-anglian-water-customer-engagement-report-14-Aug-2018.pdf> p.56

<sup>182</sup> [https://www.sustainabilityfirst.org.uk/images/publications/fair\\_for\\_the\\_future/SF\\_F4TF\\_Consumer\\_Lived\\_Experience\\_Working\\_Note\\_Oct\\_19.pdf](https://www.sustainabilityfirst.org.uk/images/publications/fair_for_the_future/SF_F4TF_Consumer_Lived_Experience_Working_Note_Oct_19.pdf)

Under Ofwat's framework, in order to encourage water companies to deliver on these 'performance commitments' there is a system of *outcome delivery incentives* (ODIs). Incentives applied to a performance commitment can be reputational or financial. Where the incentive is financial, it can result in underperformance penalties if a company does not deliver their performance commitments, or outperformance payments if they exceed it, paid from customer bills. Some of the outcomes, measures, and ODIs are set by Ofwat but with others the water companies have discretion to put forward approaches.

In line with Ofwat's PR19 methodology, all four water companies carried out a wide range of quantitative and qualitative research to understand consumer priorities, preferences, wants and needs. From our limited review it seems there is general consensus that companies have reflected these views in their proposed business plan 'outcomes'.

Companies engagement approaches towards PCs and ODIs appear to have varied in terms of: what questions they asked, how they engaged; and with whom, all of which impact the insights gathered. When well designed, it seems that engagement on the principle of rewards and penalties and the overall bill impact of a package of incentives and penalties are easier for customers to engage with.

There can also be relatively strong customer and stakeholder support for bespoke performance commitments, especially when they have been developed in collaboration with key stakeholders, though not all companies appeared to have engaged with customers on how these are defined – 'the measure'.

Feedback from the CCGs, Ofwat and the companies own engagement insight suggests that customers struggle when giving views on individual performance commitments that are more technical e.g. 'voids' and 'gap sites'<sup>183</sup>; on the reward or penalty levels that should be attached to an individual PC; how stretching a PC is; and concepts such as 'appropriate dead-bands', 'caps' and 'collars'. This is echoed by CCW research<sup>184</sup>.

Ofwat states that there are areas where customers are not best placed to give a view. For example, "this is particularly the case for determining whether companies' proposed performance commitments are stretching but achievable. Customers do not have access to the in-depth analysis of comparative and historical performance information and engineering expertise that Ofwat has applied to assess the PC levels"<sup>185</sup>.

In the words of the Yorkshire Forum for Water Customers' Chair Andrea Cook: "The performance commitment framework and ODIs are not readily understood by customers". This CCG also pointed out that environmental PCs were sometimes assessed in terms of their personal impact whilst others considered the impact more widely<sup>186</sup>. The CMA may want to consider these issues when evaluating any research.

<sup>183</sup> This challenge was mentioned by both the Yorkshire and Bristol CCG's in their respective assurance reports to Ofwat. In addition CCW's report Engaging Water Consumers for Better Consumer and Business Outcomes said that "When informed about companies' business plans, consumers find many aspects highly technical and difficult to understand – including (but not limited to) specific aspects of the water cycle, performance incentives, and the probabilistic nature of risk forecasting." P.3 Para 2.1

<sup>184</sup> Ibid. p.5 The report suggested that the least appropriated areas for customer research included regulatory metrics such as setting performance targets and penalty thresholds. p.5 Para 2.3

<sup>185</sup> [https://assets.publishing.service.gov.uk/media/5eb15fa7e90e0723b3636e74/001\\_-\\_Reference\\_of\\_the\\_PR19\\_final\\_determinations\\_Introduction\\_and\\_overall\\_stretch\\_002\\_.pdf](https://assets.publishing.service.gov.uk/media/5eb15fa7e90e0723b3636e74/001_-_Reference_of_the_PR19_final_determinations_Introduction_and_overall_stretch_002_.pdf) 3.115 p.44 Para 3.115

<sup>186</sup> <https://www.yorkshirewater.com/media/2496/yorkshire-forum-for-water-customers-pr19-assurance-report.pdf> p.24

### **Research conducted post business plan submission**

It is worth noting that companies had less time to carry out research and engagement to inform the business plan post the initial assessment of the plans. Indeed, at the CCG chairs meeting on 13 February 2019 it was agreed with Ofwat that the regulatory timeline for water companies' responses to the IAP was too tight for the companies to deliver 'best practice' research in this area. Instead, Ofwat stated that it expected companies "to take a proportionate and pragmatic approach to generating new evidence of customer support in the time available". This shortened timeline *may* have impacted both the quality of the engagement and CCG's ability to scrutinise it. This is reflected, for example in both CCW and the Anglian Water's Forum's views on the company's post business plan engagement.

### **Real world outcomes**

A number of companies argue that if the FD is agreed as it is, that it will incentivise "sub-optimal behaviour" such as perverse incentives to reduce costs over longer term efficiency and that some approaches and proposals that customers or communities value may be dropped. It is clear from the review that customers want to have confidence that prices are fair and based on efficient costs but assurances are also sought from CCGs and CCW that bill reductions will not result in different outcomes to those customers want, particularly on resilience. We would encourage the CMA to provide assurances as to how Ofwat will monitor and ensure the outcomes that customers value are delivered in practice. It may want to examine the behaviour of water companies who have not appealed to get some insights into the likely impact.

### **Recommendation**

**Customers want to have confidence that prices are fair and based on efficient costs but we urge the CMA to provide assurance that a focus on bill reductions is not at the expense of broader outcomes that consumers value.**

### **The impact of the Covid-19 pandemic on consumer attitudes**

The insight cited by companies appears to be based on engagement carried out prior to the Covid-19 pandemic. Consumer attitudes may have changed substantially since then. For example, Accenture's research<sup>187</sup>, EY's future consumer index: How Covid-19 is changing consumer behaviours and the World Economic Forum<sup>188</sup> all highlight changes in public attitudes towards security and spending which may influence willingness to pay and attitudes towards risk and resilience. Similarly, Citizens Advice has highlighted the affordability challenges that greater numbers of customers are facing in England<sup>189</sup>. For example, customers may be more willing to pay for social support schemes as they are concerned that they themselves might need help, or less likely to support them as they have less discretionary spend. Customers may be more alive to the importance of resilient networks, given increasing concerns about security or increasingly focused on short-term issues – 'surviving the here and now'. They could be more alive to environmental risks and their local communities or see immediate financial challenges as more pressing than wider climate change challenges.

Ofwat's engagement Principle 3 states that "Engagement should not simply take place at price reviews. Engagement means understanding what customers want and responding to that in business plans and ongoing delivery"<sup>190</sup>. We'd encourage the CMA and Ofwat to review company and wider emerging insight and consider conducting its own research. While we acknowledge the challenges and implications, we would query the legitimacy of a business plan determination that is made in isolation of this significantly changed context.

<sup>187</sup> <https://www.accenture.com/gb-en/insights/consumer-goods-services/coronavirus-consumer-behavior-research>

<sup>188</sup> <https://www.weforum.org/agenda/2020/05/coronavirus-covid19-consumers-shopping-goods-economics-industry/>

<sup>189</sup> <https://www.citizensadvice.org.uk/cymraeg/about-us/policy/policy-research-topics/welfare-policy-research-surveys-and-consultation-responses/welfare-policy-research/helping-people-through-the-covid-19-pandemic/>

<sup>190</sup> [https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap\\_pos20160525w2020cust.pdf](https://www.ofwat.gov.uk/wp-content/uploads/2015/12/pap_pos20160525w2020cust.pdf) p.9

**Recommendation**

The majority of insight that underpins company business plans was carried out prior to the Covid-19 pandemic. Consumer attitudes towards affordability and willingness to pay, risk, the environment and resilience may have changed substantially since then. We'd encourage the CMA and Ofwat to review emerging insight and consider conducting its own research in the medium term. While we acknowledge the challenges and implications, we would query the legitimacy of a business plan determination that is made in isolation of this significantly changed context. This could include reflecting on the need for more adaptive regulation in a rapidly changing world.



## CONCLUSION

Citizens Advice has outlined concerns that some of the appealing water companies are “misrepresenting consumer evidence to claim that consumer interests would be best served by setting higher prices for a better level of service”.

To varying degrees all four appealing water companies have argued that Ofwat has ignored, misinterpreted, or has given insufficient weight to consumer views in making its final determinations.

With regards to the PR19 final determinations, in many instances Ofwat is clear it is not ignoring the views of customers but thinks that the same outcomes that consumers want can be delivered for less. If this is the case, then these arguments would seem more about company efficiency rather than customer evidence and the two things should not be confused.

It is reasonable to assume that customers do not want to pay for inefficiency, and this is reflected in consumer comments captured as part of the companies’ own research. Nonetheless, given the concerns, we would encourage the CMA to provide assurances that a focus on bill reductions will not be at the expense of broader outcomes that customers value.

There are some instances where Ofwat acknowledges it “did override” customer research and has outlined its’ reasons for that. Where material, the CMA will likely need to assess the validity of Ofwat’s decisions on a case by case basis. Given concerns about Ofwat substituting its own views for those of customers, we would encourage transparency around the principles, methodologies, and approaches that are informing these ‘discretionary decisions.’ For example, how has the value to Bristol’s customers of it being a local, privately owned company been considered? How has Ofwat weighted consumer views in assessing the ‘need’ for schemes such as NWL’s Abberton-Hanningfield raw water transfer scheme? How have customer views on intergenerational fairness and risk been considered when balancing the affordability and resilience needs of current and future consumers? and How have any regional variations in consumer views been considered in decision making?

We would encourage the CMA to explore alternative evaluation methodologies such as Social Return on Investment, or wellbeing analysis as outlined in the Treasury Green book to ensure consumer and the wider public interest are effectively captured in decision-making. This is especially important in the current context.

The CMA may want to be especially mindful of the views of customers and stakeholders where the company has genuinely co-created an approach and worked collaboratively with the community to develop solutions; as this could impact on trust and legitimacy of water companies and regulators. This may be the case for local schemes, where engagement could have been extensive, sensitive and public views strongly held. In some instances, it may want to consider how it can communicate its final decision to relevant communities.

It seems likely that Ofwat’s initial lack of transparency in how it evaluated engagement approaches and weighted consumer views in its business plan determinations contributed to concerns about how much the regulator really took on board consumer insight. In addition, Ofwat’s reported lack of consumer engagement in developing its own PR19 methodology did not help its legitimacy in this area. We’d encourage the CMA therefore to explain for each company business plan how it has considered customer and stakeholder views and to provide a clear line of sight between the outcomes that customers say they want and the final determination.

### **Valuing engagement insights**

Assessing the quality of customer engagement and how resultant insights have been used, is notoriously difficult. The process is made more challenging by the lack of consensus across the water sector as to what best practice approaches really looks like. E.g. on triangulation.

Nonetheless, there is a general consensus among Ofwat, CCW and the CCGs that customer engagement has significantly shaped all four companies' business plans, making them better aligned to customer and stakeholder views. We'd encourage the CMA to therefore be mindful of: the overall outcomes customers say they want; their values and preferences and bespoke performance commitments in making its final determination.

There may be instances where the CMA needs to drill down into the detail of particular pieces of research. The pros and cons of different engagement approaches are well documented. Beyond that the three main sources of evidence available to the CMA when evaluating the quality of engagement in company business plan submissions are: Ofwat's own engagement assessments; customer challenge group views; and CCW's assessments and research. These sources have varying strengths and weaknesses, which we outline in this report, which should be taken into consideration when weighting their views on any given piece of engagement.

While the quality of individual research varies across companies, engagement related to overall outcomes, preferences, priorities, bespoke performance commitments and the shape of bill (the desire for stable bills) seem to be easier for customers to engage with.

A more cautious approach may be needed regarding insights on individual outcome delivery incentives, especially attitudes to rewards and penalties and caps/collars. Also, engagement conducted in response to the Initial Assessment of Plans due to the regulatory time constraints imposed. It is also well recognised that customers struggle to engage with probabilities/risk appetite, and technical concepts such as 'voids' and 'gap sites'.

The CMA should consider in particular the framing of critical pieces of research in areas of disagreement between Ofwat and the appealing companies: what options were presented to consumers; what information did and didn't consumers have available to them when they made their decisions; what were consumers' assumptions e.g. that a scheme was needed in the first place; or costs presented were accurate; or if bills went down so would the quality of service? Qualitative research should not be discarded. It can provide useful insight into the values and assumptions that are driving consumer views including driving the outcomes of quantitative surveys.

### **The elephant in the room**

It seems that the real elephant in the room is that the majority of consumer insight that underpins company business plans was carried out prior to the Covid-19 pandemic. Consumer attitudes towards affordability and willingness to pay, risk, the environment and resilience may have changed substantially since then. We would particularly encourage the CMA and Ofwat to review emerging insight and consider conducting its own research in the medium term. While we acknowledge the difficulties and implications, we would query the legitimacy of a business plan determination that is made in isolation of this significantly changed context. It feels that now more than ever there is a need for more adaptive regulation. We hope that the CMA will take up this gauntlet in its approach to this price determination.

# APPENDIX 1: Bibliography

In conducting this synthesis report Sustainability First reviewed all or part of the following documents:

## Anglian Water

- [Anglian Water PR19 CMA Redetermination Statement of Case \(2 April 2020\)](#)
- [Anglian Water Appendix 12c. Customer Research and Engagement Synthesis](#)
- [Ofwat's response to Anglian Water's Statement of Case](#)
- [Anglian Water: Ofwat's IAP engagement test area assessment](#)
- [Anglian Water Customer Engagement Forum Report to Ofwat \(August 2018\)](#)
- [Anglian Water Customer Engagement Forum, Economics and Valuation Sub-Group Annex 8](#)
- [Annex 5 Challenge Log for the Anglian Water Customer Engagement Forum](#)
- [Anglian Water Customer Engagement Forum Report: Response to Anglian Water IAP submission](#)
- [Anglian Water Customer Engagement Forum Report Response to Ofwat's Draft Determination on Anglian Water's Business Plan \(August 2019\)](#)
- [Anglian Water Customer Engagement Forum website](#)
- [The Consumer Council for Water's response to Anglian Water's Statement of Case \(May 2020\)](#)

## Bristol Water

- [Bristol Water PR19 Redetermination Statement of Case](#)
- [Bristol Water's Business Plan: Bristol Water for All](#)
- [Bristol Water's Business Plan Appendix C1: Engagement, Communication and Research](#)
- [Bristol Water Response to PR19 Draft determination. Document BW04: Financing issues](#)
- [Ofwat's response to Bristol Water's Statement of Case](#)
- [Bristol Water: Ofwat's IAP engagement test area assessment](#)
- [Bristol Water Challenge Panel website](#)
- [Bristol Water Challenge Panel Annual Report 2018/19](#)
- [Bristol Water Challenge Panel Assurance Report to Ofwat \(2018\)](#)
- [BWCP response to the IAP](#)
- [BWCP response to the draft determination](#)
- [CCW's response to Bristol Water's Statement of Case](#)

## Northumbrian Water

- [NWL's Statement of Case: PR19 CMA Determination](#)
- [Appendix 2.2 to NWG's business plan -Customer engagement executive summaries for PR19 Essex and Suffolk](#)
- [Northumbrian Water PR19 acceptability research report](#)
- [Ofwat's response to Northumbrian Water's Statement of Case](#)
- [Northumbrian Water: Ofwat's IAP engagement test area assessment](#)
- [Northumbrian Water and Essex and Suffolk Water Forums report to Ofwat regarding NWL's business plan 2020-2025](#)
- [The Northumbrian and Essex and Suffolk Water Forums' Supplementary Report to NWL's Business Plan resubmission](#)
- [The Northumbrian and Essex and Suffolk Water Forums' Draft Determination response](#)

- [The Northumbrian and Essex and Suffolk Water Forums' Response to the invitation from the CMA for comments](#)
- [CCW's response to the Competition and Markets Authority about Northumbrian Water's statement of case in its request for a redetermination of its Ofwat 2019 Final Determination](#)
- [Water Forums: website](#)

#### **Yorkshire Water**

- [Yorkshire Water's PR19 Redetermination Statement of Case](#)
- [Yorkshire Water. Business Plan Appendix 5a: Customer and Stakeholder Engagement](#)
- [Ofwat's response to Yorkshire Water's Statement of Case](#)
- [Yorkshire Water: Ofwat's IAP engagement test area assessment](#)
- [Yorkshire Forum for Water Customers' PR19 Assurance Report](#)
- [Yorkshire Forum for Water Customers: Comments on Ofwat's Initial Assessment \(IAP\) of Yorkshire Water's PR19 business plan and the company's response](#)
- [Yorkshire Forum for Water Customers response to the Draft Determination](#)
- [Yorkshire Forum for Water Customers Letter to the CMA \(7 May 2020\)](#)
- [Yorkshire Forum for Water Customers: website](#)
- [CCW's response to the Competition and Markets Authority about Yorkshire Water's statement of case in its request for a redetermination of its Ofwat 2019 Final Determination](#)

#### **Other**

- [CCW: Engaging Customers water customers for better consumer and business outcomes](#)
- [Citizens Advice: submission to the CMA on the Ofwat price determination appeals](#)
- [ESAN: How can the consumer voice be better heard in the regulation of essential services?](#)
- [National Infrastructure Commission: Social Research – regulation & resilience](#)
- [Ofwat: Aide Memoire for Customer Challenge Groups](#)
- [Tapped in: From passive customer to active participant](#)
- [Ofwat's PR19 initial assessment of plans: Summary of test area assessment](#)
- [Ofwat's customer engagement policy statement and expectations for PR19](#)
- [Ofwat's Reference of the PR19 final determinations: Outcomes – response to common issues in companies' statements of case](#)
- [Ofwat's Reference of the PR19 final determinations: Introduction and overall stretch on costs and outcomes – response to cross cutting issues in companies' statements of cases](#)
- [Review of Ofwat and consumer representation in the water sector](#)
- [Time to Act, together: Ofwat's strategy](#)