
Customer engagement for PR24 and beyond

Evolving the directions
for customer engagement
in the water industry

An ICS report commissioned by Northumbrian Water Group.

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Foreword

ICS report – Customer engagement for PR24 and beyond

We are passionate about understanding and engaging with our customers to provide an unrivalled customer experience, now and for the long term.

That is why being ‘customer focused’ is one of our core values as a business¹, and it is why our service commitments to customers include, for example, objectives to have two million customers engaging with us by 2025² as well as maintaining strong levels of customer trust³.

We put customers at the heart of everything we do. It is therefore very important to us that we engage directly with them and can own and champion that relationship. We want to be constantly listening to their needs and views so that we can reflect them in the essential services we deliver every day and our plans for the long-term.

We embraced and supported the emphasis that regulation has placed in the last two price reviews on engaging customers directly and seeking to develop plans that reflect and incentivise the delivery of the long-term outcomes that they want.

The emphasis on deeper engagement with customers in developing future business plans, the flexibility offered by the outcomes framework and the robust challenge and assurance provided by the Customer Challenge Groups, including our Water Forum, has not only driven better and more stretching plans with enormous positive innovation but has also helped to drive greater focus on customers in companies’ day to day operations.

Despite those efforts during the past price review it was often difficult to see how that evidence had been reflected in the final decisions taken. We considered that evidence on customer preferences was given less weight in decisions than it could have been.

At the same time, we also recognised that there were important aspects that we could have done better and some of the challenges raised by the regulators were reasonable and fair. For example, Ofwat has reasonably identified that there was wide variation in the incentive rates that companies proposed for different service levels that was difficult to justify.

We wanted to learn from the experience and improve those approaches for the future.

We therefore commissioned this thorough review from ICS to identify what worked well for PR19, what should continue, and think about what we could have done better.

As ICS have been carrying out this work the regulatory landscape has continued to evolve in parallel and there has been significant discussion around the approach to customer engagement for PR24 and several helpful and important contributions made to the debate. In its report ICS has tried to capture these contributions in its work to set out a framework for engagement that we can consider for PR24 in light of the regulatory context. We are sharing this work through the Future Ideas Lab in case other companies and their customers can benefit from the framework and proposals outlined in the ICS report.

¹See: www.nwg.co.uk/about-us/nwl/what-we-do/our-vision-and-values This includes: "Customer focused: We aim to exceed the expectations of our external and internal customers."

²See 'Living Water, Our Plan for 2020-25 and beyond', Northumbrian Water Limited, p.18.

³See 'Living Water, Our Plan for 2020-25 and beyond', Northumbrian Water Limited, p.74.

Setting out our approach to PR24

We asked ICS to consider a number of questions about how our approach for PR24 could improve, alongside other external changes to the framework.

Based on that work, we are intending to follow the proposals the report sets out, including:

- Continuing to place a very strong emphasis on engaging with and understanding our customers for PR24 by embedding the six proposed engagement principles in our approach, adopting the proposed engagement framework in the report and seeking to engage customers on those topics where ICS (and others) identify customers can meaningfully give views.
- Supporting and using Ofwat and CC Water's centralised research on service incentives and triangulating the results of that work with other evidence in developing our business plan.

- Continuing with the Water Forum that we currently have in place but changing their role to align with CCW's proposals around the creation of a central oversight group, strengthening their independence through additional recruitment to the forum, and by giving them their own resources to challenge the plans.

Engaging customers for the long-term

Ofwat has introduced positive change to the regulatory framework for PR24 by encouraging a stronger focus on long-term planning. This approach can help to set the business plan in an appropriate long-term context. As Ofwat acknowledges based on other research it can be very challenging to engage customers on long-term issues. That being noted, Ofwat still considers, and we agree, that it is crucial that we seek to engage constructively and robustly with our customers. Ofwat suggests that this engagement should take place on:

- The level of ambition in the long-term plan including the service levels and statutory requirements that companies will need to meet by 2050.
- The strategy and rationale for the plan including trigger points or choices over a 25-year period that need to be considered and chosen to drive different investment solutions.

The ICS report considers the challenges associated with this approach and sets out a framework that embeds this into the engagement with customers.

We have begun this engagement initially through the creation of 'People Panels'. These are regional representative groups that include both current and future customers across our operating areas. We are using this deliberative model in light of the complexity of the issues and we are also seeking to triangulate the results with other evidence, including more informed challenge through the Water Forum and independent expert views.

Through these engagement channels and groups we intend to discuss and agree certain scenarios for the future and how different personas could be affected. Given these scenarios we are then seeking to establish what level of ambition customers would support and the balance between service improvement and affordability. This will then drive long-term plans to deliver those ambitions which will include choices or 'trigger points' within them that can also be discussed and agreed with customers to understand an overall package, strategy and rationale that we should be targeting for 2050.

We welcome feedback on our proposed approach. Please email haveyoursay@nwl.co.uk to share your views.

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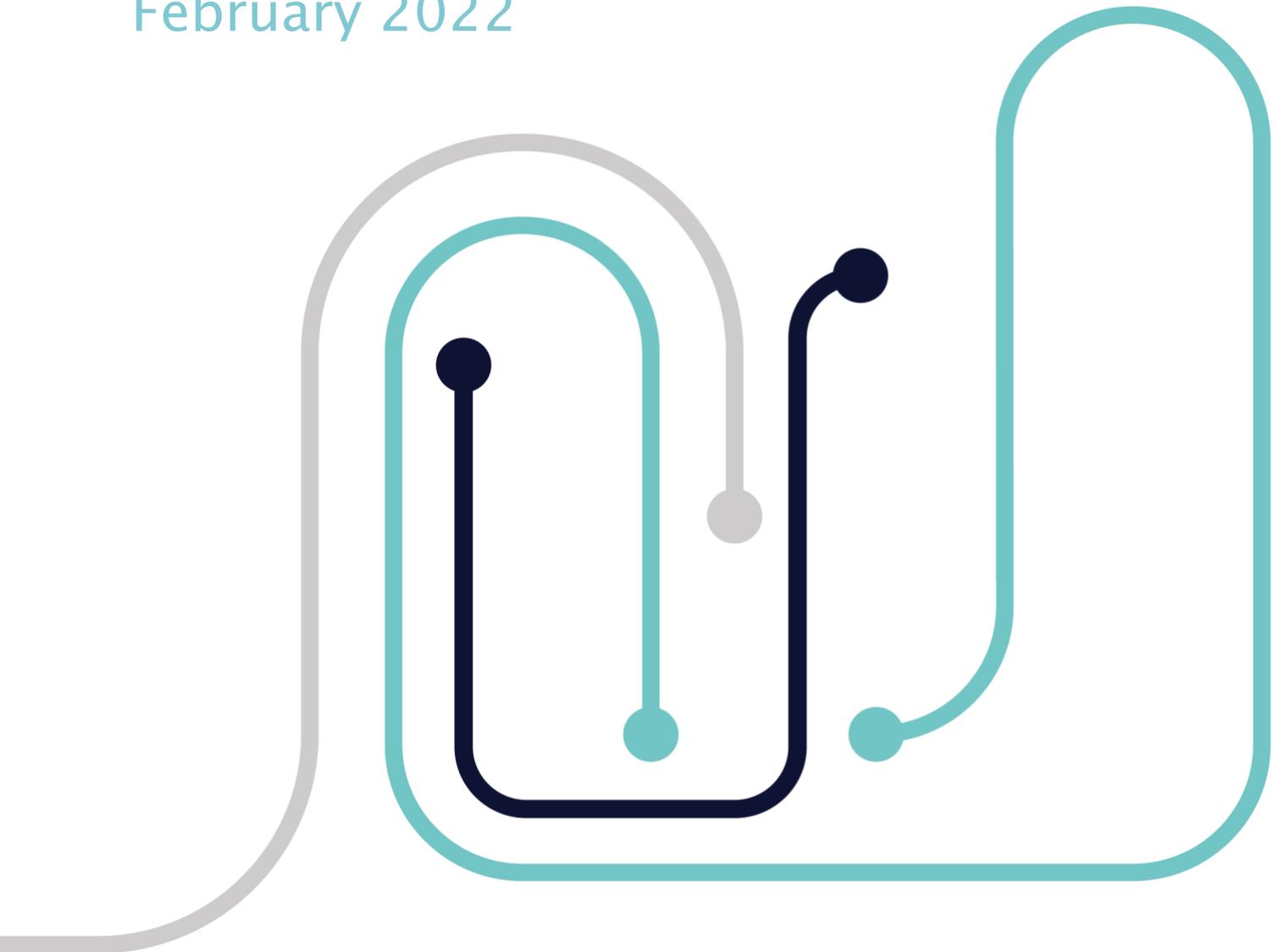


Northumbrian Water

Customer Engagement for PR24 and Beyond

*Evolving the Directions for Customer
Engagement in the Water Sector*

February 2022



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1 Introduction

"..the debate about customer engagement is also shaped by fundamental questions about the role of citizens and customers in regulated markets."

*Darcy, S. et al Centre for Analysis of Risk and Regulation – Customer Engagement in regulation Discussion Paper No. 82
February 2016*

Water companies provide services that are vital to the public health and environmental sustainability of the nation. These services are largely shaped by the constraints of geography and catchments, which also gives prominence to the regional structure and local importance of water services. The supply of these network services for related reasons also remains in the most part the preserve of monopoly providers, and therefore highly regulated.

Water customers are therefore largely unable to choose the supplier, level and quality of the services that they procure based on their individual requirements together with their ability and/or desire to pay. The dynamics prevalent in commercial competitive markets simply do not exist. Rather than using customer engagement to develop / refine product offerings and to influence what consumers want to buy, water company engagement needs to go wider and deeper. It needs to embrace the regional and local circumstances that shape service delivery and it needs to provide the means for water companies to understand what matters to the populations they serve about the services they receive now and in the future.

In addition, any engagement needs to address the long-term nature of providing water services. Decisions made today have the potential to lock in how services are delivered for years and decades to come.

1.1 Project objectives and approach

Northumbrian Water Group (NWG) – like many other water companies – has progressively developed its customer engagement programmes to address these needs. To build upon its existing approaches, NWG commissioned ICS Consulting (ICS) to review its current approaches and make recommendations on how to develop the approaches going forward.

To understand what those future directions need to look like we have undertaken two sets of activities:

- A desk-top review of literature on customer engagement, covering both literature which is water sector specific and from other sectors; and
- A set of consultations with experts and practitioners drawn from a wide range of backgrounds – academics and policy advisors, regulators, consumer representatives, market research specialists and executives and managers from within and outside of the water sector.

Based on our review and consultations, this report sets out our high-level recommendations on the future directions for water company customer engagement. These recommendations we believe have general applicability across the water sector.

In a separate report we have provided NWG with a more detailed review alongside a recommended framework and roadmap of customer engagement activities.

Throughout our reporting we have used the term customer engagement as our preferred terminology. To be clear, we use the term "customer" to mean anyone, or any group impacted by the decisions of a water company; who have a stake in the associated outcomes and therefore deliberations. This can mean broadly customers (bill-payers), consumers, citizens or communities.

1.2 Report Structure

The rest of this report is structured as follows:

- Section 2 sets out the context for this review focusing on recent experiences with customer engagement in water and other sectors and the factors shaping the future directions for customer engagement.
- Section 3 presents our findings and recommendations on customer engagement for the 2024 price review (PR24) and beyond. This includes the future role of Customer Challenge Groups (CCGs).
- Section 4 considers further options on customer engagement, specifically exploring the potential for empowering customers to be part of decision-making.
- Section 5 provides our conclusions and a summary of recommendations.
- We also provide a bibliography of the literature reviewed along with details of the individuals and organisations we consulted as part of our review.

2 Context for our review

2.1 The evolution of customer engagement in water

As noted in our Introduction, the characteristics of water services supply give prominence to a need for regulation – economic and environmental. For economic regulators in particular the post-privatisation desire has been to mimic as far as possible the disciplines and outcomes observed in competitive markets. In competitive markets business survival often rests with the quality of customer engagement to understand the products and services that customers demand and are willing to pay for.

The flip side of this has been that the demands of the regulatory system – which have tended to increase not decrease in the post-privatisation period – run the risk of becoming the central focus for regulated companies in utility sectors; almost a substitute for customers.

Both regulators and companies have recognised a need to counter these risks of regulatory processes and the use of customer engagement at regulatory reviews and for day-to-day management has offered ways to address this potential imbalance. The evolution of this use over successive reviews has seen efforts to strengthen the robustness of the analysis and the meaningfulness of the research, for example through the development of more easily understood materials to aid both the respondents understanding of the services provided and therefore the validity of their contributions.

THE EARLY STEPS

In the water sector, the 1994 price review provides the first evidence of direct engagement with water customers as an input to a water regulatory review. The focus for this input was on areas of service improvements and customer willingness to pay:

"We believe that the efforts made by the Director to involve customers in the Periodic Review are an important step forward in the way private sector monopolies are regulated...In the Autumn of 1992, companies were asked to consult their customers on what quality of service they wanted and how much they were prepared to pay...The clear conclusion was that willingness and ability to pay ever higher water bills were the key issues. It was disappointing that not all companies responded to that conclusion"

Statement by the Chairman of the Ten Ofwat Customer Service Committees, Ofwat (1994) Future Charge for Water and Sewerage Services: The outcome of the Periodic Review, July 1994, pp 55-58

PR99 witnessed ever greater canvassing of customer views with companies, national industry bodies like Water UK as well as Ofwat itself (and the CSCs) seeking to understand customers' service priorities and preferences through tools such as customer surveys. As well as seeking to understand willingness to pay, there was also focus on broader concerns like bill profiles; an area where the engagement produced conflicting evidence:

"Companies' research suggested that customers would rather see five years of stable prices than an initial reduction followed by increases to reflect the cost of improvements. Ofwat's research indicated that a majority of customers would prefer a profile incorporating an initial price reduction but also that this was not an issue on which customers have particularly strong views."

Ofwat (1999) Future water and sewerage charges 2000-05, pp 67

The PR99 experience and outcome provides an interesting perspective on the issue of listens and responds to the customer view.¹ In competitive markets there is no ambiguity on this. Successful businesses will be the ones who through their engagement acquire and retain customers, who of course have choices in these settings. Whereas, in a regulatory setting like PR99 it became clearer that not all engagement and evidence will necessarily be weighted in the same way.

This potential for regulators and companies to disagree over what the customer “wants” only heightens, in our view, the importance of companies being responsible for understanding, through engagement, the voice of the customers they serve. Moreover, it was also abundantly clear at this stage that companies had to do more to demonstrate how customer evidence was shaping and influencing their regulatory plans.²

FIRST MOVES

The first step in this direction was taken by Yorkshire Water with the innovative development of L(eading) E(dge) A(sset) D(ecision) A(ssessment) ahead of PR04. LEADA was a planning tool built on economic optimisation principles with competing investments selected and prioritised on a cost benefit basis. The benefits of investments were quantified in terms of customer willingness to pay estimated using stated preference techniques that had hitherto only been explored in academic research.³ The work by Yorkshire Water, especially on estimating customer benefits, quickly established a benchmark for the water industry:

“the LEADA system...should become the benchmark development of capital maintenance planning approaches for those companies or water and sewage providers which elect to follow the cost-benefit planning objective.”

UKWIR (2003), Capital Maintenance Planning Manual: Current Methods and Good Practice Guidance, UKWIR Report 03/RG/05/4

This benchmark was quickly embraced by the water industry ahead of PR09 where the breadth, complexity and robustness of customer valuation approaches evolved further and were guided by the publication of best practice through industry bodies like UKWIR.⁴

ADOPTION AND LEARNING

The developments by companies also found echo in the expectations outlined by Ofwat ahead of PR09:

“We have long emphasised the role of cost-benefit analysis in understanding and delivering value...In the past, analysis has tended to concentrate on costs of supply,

¹ The PR99 final determinations saw notable “Po” price reductions in the first year for all water companies, followed by a profile of small annual price increases in real terms. This would align with the customer evidence provided by Ofwat’s own research.

² After the PR99 final determinations, Ofwat had identified in MD161 investment to maintain assets as a key area for development at PR04 with the core principle being companies developing the economic case for capital maintenance investment. Ofwat (2000) MD161 Maintaining serviceability to customers: Letters to managing directors of all water and sewerage companies and water only companies.

³ Willis, K., R. Scarpa and M. Acutt (2005) Assessing Water Company Customer Preferences and Willingness-To-Pay for Service Improvements: a stated choice analysis. Water Resources Research 41(2) February 2005.

⁴ UKWIR (2007) The role and application of cost benefit analysis: Volume 1 Generic guidance, Report by ICF International, 07/RG/07/9 and UKWIR (2007) The role and application of cost benefit analysis: Volume 2: Sewer Flooding guidance. Report by ICF International, 07/RG/07/10.

rather than the value of the improvements delivered by the water industry. If we take decisions without seeking to value benefits, we make opaque and untested assumptions about benefits. Cost-benefit analysis exposes decision-makers' assumptions to analysis and challenge in pursuit of value."

Ofwat (2006) A sustainable water industry – To PR09 and beyond. October 2006, pp 7-8

In line with this the regulator's methodology for PR09 gave prominence to the role of cost benefit analysis (CBA) as a key business planning tool for companies:

"The use of CBA to inform the construction of each company's business plan is vital for ensuring transparency of investment proposals to consumers. A company can use a CBA developed plan to explain its investment decisions to its consumers, regulators and other stakeholders and demonstrate that its business plan maximises the benefits relative to the costs."

Ofwat (2007) Further Ofwat guidance on the use of cost benefit analysis for PR09. PR09/08 Letter to all Regulatory Directors of Water and Sewerage Companies and Water Only Companies

PR09 also saw the introduction further initiatives including customer research to help to define Strategic Direction Statements setting objectives for 25 years into the future and the introduction of joint acceptability research to test plans by Ofwat, customers and other stakeholders.⁵

If PR09 had confirmed the need for better and more systematic evidencing of customer priorities and preferences, it could be said that PR09 cemented the adoption of methods like cost benefit analysis underpinned by engagement designed to estimate customer WTP. At the same time it was understood that further progress and improvement was still needed.

CONSOLIDATION AND INNOVATION

The desire for this progress and improvement was embodied in two subsequent industry-led reviews.

First, UKWIR (2010) reviewed the PR09 experiences with cost benefit analysis and benefits valuations leading to a Practitioners Guide setting out best practice methods in both areas.⁶ The report highlighted the areas where methods and applications needed to improve particularly around the understanding of customer preferences, but also revealed important areas of progress:

"CBA should never be seen as a precise science. It is only a decision support and not a decision-making tool. This is indeed the purpose for which CBA was created and is also a purpose that finds widespread support in the industry.

CBA should not also be seen as a purely technical planning tool. The better experiences with CBA were evident in those companies that are beginning to embrace the objectives of CBA within their planning and delivery cultures and processes."

⁵ The testing of customer acceptability was introduced as Step 3 of establishing customer preferences at PR09. This was to explore consumers' views on the value for money, acceptability and affordability of companies' draft business plan proposals. See Ofwat (2008) Setting price limits for 2010-15: Framework and approach.

⁶ UKWIR (2010) Review of Cost-Benefit Analysis and Benefit Valuation. Report 10/RG/07/18.

UKWIR (2010) Review of Cost-Benefit Analysis and Benefit Valuation. Report 10/RG/07/18, Executive Summary.

One of the recommendations of this industry review was for the development of a common valuation framework to help standardise approaches to, in particular, the estimation of customer willingness to pay. The subsequent and related industry review set out in UKWIR (2011) provided the anticipated templates for undertaking willingness to pay surveys providing guidance on key areas of survey design, including for example ways to present information to customer on levels of service risk.⁷

The regulator's methodology for PR14 endorsed the need for both the understanding of customer willingness to pay and its use in developing business plans consistent with CBA.⁸

"Each company's proposed package should reflect their customers' views and priorities. Companies should be able to demonstrate that they understand the value their customers place on the delivery of particular outcomes.

We expect companies to have carried out willingness to pay surveys and collected other forms of evidence to back up their proposals, where appropriate.

In determining their committed performance levels, companies should consider the related costs and benefits, building on the cost-benefit analysis carried out at the 2009 price review."

Ofwat (2013) Setting price controls for 2015-20 – framework and approach. A Consultation, pp 33-34

The introduction at PR14 of Performance Commitment Levels (essentially service measure targets) alongside the development of Outcome Delivery Incentives (ODIs) were also notable in terms of the evolution of customer engagement in the water sector. With a heightened focus on outcomes for customers and how to measure outcome delivery, engaging customers was understood to require a much broader set of activities than willingness to pay and CBA and companies felt the changes had helped to re-enforce a customer centric focus within their business planning.⁹ This also chimed with wider developments in other utility sectors where customer / consumer engagement was eagerly embraced by regulators as an additional set of tools to improve regulatory outcomes in ways that would also enhance the public legitimacy of regulatory processes.¹⁰

There was also a wider desire for regulatory reviews to be more proportionate in the terms of the information and scrutiny required. To this end Ofwat introduced at PR14 a risk based "tournament" encouraging companies to qualify for enhanced status and a "lighter" touch approach at the PR14 review. One of the criteria for achieving this enhanced status was the quality of customer engagement underpinning the draft business plans and instrumental to this quality was being innovative in the tools and methods used in customer engagement.¹¹ Overall, PR14 saw a significant step change in the quantity and quality of customer research with more innovation across all areas of

⁷ UKWIR (2011) Carrying out Willingness to Pay Surveys. Report 11/RG/07/22

⁸ In a further reflection of industry guidance Ofwat also highlighted the role for other methods for estimating willingness to pay such as revealed preferences as set out in Cascade Consulting/eftec (2011) The use of revealed customer behaviour in future price limits. Final Report for Ofwat, April 2011.

⁹ For example, Ofwat (2015) cites "Senior people within companies have told us how the focus on outcomes and customer engagement changed the nature of the conversations with their Boards, and helped to engage their staff." Ofwat (2015) Reflections on the price review – learning from PR14, July 2015.

¹⁰ See Darcy, S. et al Centre for Analysis of Risk and Regulation – Customer Engagement in regulation Discussion Paper No. 82 February 2016

¹¹ For example, PR14 saw the first examples of companies exploiting online technologies through tools like trade-off "games" to understand customer priorities and acceptability around bills and service.

engagement. Through the setting of performance targets, the aim was to align the customer voice with the incentives for companies.

PR14 also saw a requirement for companies to set up Customer Challenge Groups (CCGs) that more formally brought consumer representatives and stakeholders together to challenge company business plans and provide assurance on customer engagement. It has been observed, however, that the overall remit of the CCGs suffered from a lack of direction and guidance resulting in ambiguity about their role in the regulatory process. During our consultations for this project we heard observations that this ambiguity was still in evidence at PR19.

"There has always been a bit of ambiguity over precisely what CCG should be doing. The ones I dealt with in PR14 were doing this and arguably venturing into territory (e.g. WACC) where they had no comparative advantage. But there was also a narrower role which was to ensure the company was engaging properly with customers and that what it claimed to represent the views of customers actually did. This ambiguity persists."

Interview with Independent utilities expert/commentator

DEVELOPING TRUST AND SHARED VISIONS

"We expect companies to demonstrate a clear commitment – across the entire business – to genuinely understanding and responding to the different needs and requirements of their customers. This is key to building legitimacy and trust"

"Our shared vision for the water sector in England and Wales is one where customers and wider society have trust and confidence in vital public water and wastewater services. Delivering this vision relies on everyone in the sector working together, listening to customers and tackling long-term challenges"

"We not only expect companies to be responsible for engaging directly with their customers (as they are best placed to develop a genuine understanding of customer needs and requirements) but to use this information to drive decision making and provide excellent levels of service to all customers."

Ofwat, 2016, Ofwat's customer engagement policy statement and expectations for PR19.

At PR19 the level of engagement further increased following Ofwat challenging companies to be more expansive and innovative in their engagement methods. There was a new emphasis on customer participation defined as:

"The active involvement of customers in the design, production, delivery, consumption, disposal and enjoyment of water, water services and the water environment in the home, at work and in the community"

Ofwat (2017) Tapped In: From passive customer to active participant, March 2017.

This broadened the engagement agenda from "how do customers value water" to "how do customers want to experience water". This new emphasis on participation underpinned imaginative efforts by a number of companies, including NWG, to make co-creation with customers, stakeholders and more widely, communities a part of the business planning process.

The engagement at PR19 also expanded into a more continuous process, developing a two-way dialogue with customers, using comparative information in valuation studies and understanding the needs and requirements of different customers. Innovative approaches saw digital channels increasingly drawn upon for the wealth of information and insight that can be derived from these routes. Increasingly qualitative engagement has moved from one-off focus groups towards more informed customer panels, deliberative workshops, co-creation for policies and gamification.

Overall, Ofwat's own reflection was that at PR19 companies responded well to its engagement challenges and delivered a significant volume of research of substantially increased quality¹².

In 2017 the UK Regulators Network (UKRN) recognised that, in general, there has been an increase in how regulators have encouraged and incentivised companies to listen to consumers.

“There has been a step change in how regulators encourage and incentivise companies to listen to their consumers over the past ten years, to bring the consumer voice into business-decision making rather than regulated companies focusing their efforts on discussions solely with the regulator.”

UKRN (2017) Consumer engagement in regulatory decision making. A guide to how UK Regulators involved consumers, hear their views and take their interests into account. (2017)

It is evident that the journey that water companies have taken in customer engagement has previously been a journey prompted in part by regulators and other stakeholders. It is also evident that along this journey companies have been willing to embrace these promptings and use them to embed more customer centric cultures within their businesses.

The experiences from PR19 perhaps provide a turning point in that there has never been a greater appreciation of the *business* benefits of customer engagement. It is simply the right thing to do and this goes beyond the requirement of any regulatory process. This was reiterated by the Competition and Markets Authority (CMA) in the recent water price re-determinations where it was recognised that conducting customer and stakeholder engagement has wider benefits to companies beyond establishing the envelope of willingness-to-pay:

“We consider that research into customer views can play an important element in informing the price review process, including gaining an understanding of ability and willingness to pay, and views on the balance of probabilities. There are also likely to be substantial broader benefits from customer engagement in influencing company behaviour, regardless of the use in price review processes.”

Competition & Markets Authority (2021) Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations. Final Report, 17 March 2021, para 3.28

Customer engagement is now understood as providing the means for un-locking new company behaviours, thinking and more customer-focused business cultures.

However, this journey did not end with PR19 and for those water companies that wish to remain at the forefront of generating customer insight as part of business as usual and business planning there is a need to continue to evolve their engagement approaches and methods to meet future challenges.

¹² As noted by Ofwat (2020) PR24 and beyond: Our reflections on lessons learnt from PR19. It also noted in these reflections that “Several water companies told us that their customer research was their proudest achievement from PR19. We also recognise the move in many water companies’ cultures towards being more customer-centric at PR19.”

2.2 What did good engagement look like at PR19?

Customer engagement at PR19 was one of the areas scrutinised in Ofwat's Initial Assessment of Plans and therefore had a degree of influence on the initial categorisation of plans into "exceptional", "fast-track", "slow-track" and "significant scrutiny".¹³

Three companies achieved "fast-track", four required "significant scrutiny, with the remaining ten (including NWG) deemed "slow track" and requiring further work.

Ofwat defined nine test areas, which included Engaging Customers. Within the overall assessments there was no overall clarity around the weight associated with each test area. For example, none of the fast-track companies received the highest assessment on Engaging Customers, whereas one company slow-track (Anglian Water) achieved the only top assessment on Engaging Customers. Anglian Water was also one of the 4 slow-track companies to subsequently refer its final determination to the CMA.

On Engaging Customers the test question used by Ofwat was:

"What is the quality of the company's customer engagement and participation, and how well is it incorporated into the company's business plan and ongoing business operations?",

with the companies rated using:

- A: High quality. Ambitious and innovative plan with evidence that overall is sufficient and convincing (1 company – Anglian Water)
- B: High-quality plan, not sufficiently ambitious and innovative to be exceptional with evidence that is overall sufficient and convincing (9 companies, including NWG)
- C: Concerns with the plan: Plan falls short of high quality and/or evidence is insufficient and/or unconvincing in some areas (7 companies)
- D: Substantial concerns with the plan: Plan falls significantly short of required quality and/or little or no evidence or no convincing evidence (No companies).

In the assessment of the Engaging Customers test areas, CCGs were given the role of providing independent assurance on engagement quality. At the time of the initial assessment of plans Ofwat was generally supportive and appreciative of the work provided by the CCGs in this area:

"We welcome the contribution that customer challenge groups (CCGs) have made to providing independent assurance of the quality of engagement between companies and customers. We see that the quality of customer engagement is improved as a result of the CCG's independent challenges to their water company."

Ofwat (2019) PR19 Initial assessment of plans: Summary of test area assessment. January 2019, p 5.

This appreciation of the CCGs became more ambivalent in Ofwat's subsequent reflections on PR19 and then its statements to the CMA price determinations.

"We reflect that the engagement with CCGs in PR19 worked better than at PR14. However, we agree that more guidance and/or engagement and greater explanation of

¹³ Ofwat (2019) PR19 Initial assessment of plans: Summary of test area assessment. January 2019. <https://www.ofwat.gov.uk/wp-content/uploads/2019/01/PR19-initial-assessment-of-plans-Summary-of-test-area-assessment.pdf>

the challenge given to companies by CCGs could have made the process more effective.”

“CCW reflected that the challenge logs – which were intended to be the means for CCGs to communicate with Ofwat where they had challenged companies – were helpful. But some CCW members of CCGs had difficulty getting CCGs to complete the log as some CCGs wanted to be more of a critical-friend to companies.”

“Finally we note that unfortunately, at PR19 not all CCGs provided the levels of evidence required to demonstrate that they were effectively operating at arm’s length from their respective companies. While insufficient evidence of independence does not, on its own, mean that these groups were not acting independently of their company, this inevitably reduced the weight we could place on the evidence provided in their assurance reports.”

Ofwat (2020) PR24 and beyond: Our reflections on lessons learnt from PR19

“We expected customer challenge groups (CCGs) to provide independent challenge to companies and independent assurance to us on: the quality of a company’s customer engagement and the degree to which this is reflected in its business plan..... we did not expect CCGs to endorse a company’s overall business plan, nor did we expect them to act as a substitute for the views of customers.”

“broad indications of customer preference obtained as part of an engagement process should certainly serve to shape company business plans. But they do not relieve the companies of the need to evidence either the need for or efficiency of their proposed expenditure. Nor does broad customer support immunise company business cases from appropriate regulatory scrutiny and challenge.”

Ofwat (2020) Reference of the PR19 final determinations: Introduction and overall stretch on cost and outcomes – responses to cross-cutting issues in companies’ statement of case, May 2020.

We reflect further on the future for CCGs in the sections below.

EXAMPLES OF ‘GOOD ENGAGEMENT’ AT PR19

In its published assessments of the PR19 customer engagement by companies, Ofwat published examples of what it considered “good”. Not surprisingly, these draw heavily on the company rated as “A” (Anglian Water), but also companies rated as “B” (including NWG).

Anglian’s overall approach to their customer research and triangulation was singled out for praise as it used a number of engagement techniques to provide evidence for business planning and customer segmentation. This included “innovative multi-stage ‘willingness to pay’ research, which was externally assured.”¹⁴ Ofwat also highlighted a “clear line of sight” between customer evidence and proposals in Anglian’s approaches. Failure to provide this line of site was a weakness directed at other companies.

Anglian were ambitious and innovative in Ofwat’s eyes when engaging with future customers¹⁵, considering longer term issues, informing customers with comparative information and tackling challenges such as intergenerational fairness.

¹⁴ Ofwat (2019) PR19 initial assessment of plans: Summary of test area assessment.

¹⁵ Future customers were defined as younger age groups who were not yet bill payers.

Anglian Water, NWG, Wessex Water and United Utilities all provided evidence of sector-leading approaches in adopting co-creation approaches motivated by the “Tapped In” customer participation agenda.

Other examples cited by Ofwat were:

- Northumbrian Water provided high-quality evidence of several approaches to talking and listening to customers. For example, its mobile engagement vehicle (Flo) visited a range of communities across the company’s regions. Very positive views about this example from both within and outside of the company were also heard during the consultations for this project.
- NWG’s involving of customers in designing the overall engagement programme (‘Defining the Conversation’, 2016) and then inviting the same customers back in 2018 to take part in research about whether the business plan was acceptable. Customers also joined a senior leadership team conference in 2017 and co-created elements of the PR19 business plan.
- Wessex Water’s approach to adopting the principles of customer participation. This was viewed as high quality and demonstrated innovation and ambition. Examples cited were the water citizenship project and the co-creation of the ‘Money Back Guarantee’ with the Young People’s Panel (to encourage more people to get water meters).
- Evidence of high-quality ongoing customer engagement by Wessex Water. For example, the use of feedback data, complaints, social media and other contact data to inform its performance commitments. A customer opinion tracker survey was also used throughout the year to provide comparable data and short snapshots of customer views at a given time.
- Yorkshire Water’s use of behavioural economics techniques (for example, better context and framing to improve customer understanding) to help customers make more informed choices in customer preferences research. This was attributed to higher levels of customer understanding (91% compared to 74% at PR14). Where available, the company also used comparative data from other water companies.
- Evidence from United Utilities to show how it has done research with the most disengaged customers. It used the results to develop ways to engage this group on an ongoing basis, and to influence its performance commitments for vulnerable customers and water poverty.

All of these examples and the breadth of the customer engagement work undertaken at PR19 by the water companies underpinned Ofwat’s overall assessment that performance in this area was good.

2.3 Learning from the PR19 experiences

A key part of the desk-top review and interviews consultations was to identify the principal learning points and issues from the industry wide PR19 experiences. We synthesis below the key learning points :

Scope to improve the targeting of engagement

In many of the consultations it was felt there was room to better target engagement activity, questioning the need for the volume of research undertaken at PR19 and suggesting a focus on the most effective activities. The challenge here is to make research and engagement meaningful and have a clear use in business planning or business-as-usual use, and to demonstrate value to consumers and stakeholders because, ultimately, it is the customers who pays.

Greater clarity on the use of engagement in business planning

Stakeholders and commentators have continued to highlight the need to demonstrate the rationale and golden thread of how engagement evidence is integrated and has been practically used to influence the development of companies’ plans.

Variations in Customer Valuations

Ofwat and others have highlighted perceived unexplained variances in customer valuations.¹⁶ Both Ofwat and CCWater have proposed a number of solutions including centralised customer research.

This centralisation of some aspects of the PR24 customer research is intended to bring cost efficiencies by minimising repetition of research across the industry, but primarily it is a means by which Ofwat/CCW believe the comparability of the value estimates used to set Outcome Delivery Incentives can be ensured.

This focus on centralised research currently leaves the importance of triangulation and the challenge of values uncertain. For example, there is no clarity yet around how Ofwat/CCW will triangulate with respect to its own (single source) centralised research. The CMA in its deliberations concurred with Ofwat's views on the need for comparability, but this reinforced in its mind the importance of triangulating multiple evidence sources.

Role of the CCGs

As we have noted above, in the aftermath of the PR19 process questions have arisen of the remit and role of the Customer Challenge Groups (CCGs) and queries on the extent to which they are genuinely independent of companies.¹⁷

CCWater and Ofwat raised publicly non-specific concerns citing inconsistency of CCG challenge to company plans and in some cases adopting a "critical friend" approach. However, as we heard in our consultations a form of agreement at the end of a process often provides evidence of challenge and disagreement during the process. In considering independence, it is particularly important to understand and be transparent about what challenges were made along the way.¹⁸

As a counter to this we heard from both sides involved in the CCG process that it was effective and the challenge process added significant value to the business planning process.

Several companies, including NWG, set out to mitigate governance concerns upfront through actions such as independently procuring the Chair and group members, and in our consultations group members were at pains to express the importance of this independent procurement alongside other governance processes designed to ensure independence.

In addition to governance arrangements, a number of further issues on CCGs have been raised. CCW for example raise issues around the asymmetry of information between the company and the CCGs and a lack of comparative data as an input to the CCG challenge process.¹⁹ Both of these issues provide motivations for CCW's proposed consumer representation model for PR24 which includes a Central Oversight Group.

Going forward, Ofwat's decision to no longer mandate a role of CCG leaves companies with a key decision about their future role and constitution. We return to this issue in section 3.5.

Lack of Inclusion of Engagement Evidence

¹⁶ Ofwat (2021) PR24 and beyond position paper: Collaborative customer research for PR24, October 2021. In the earlier Ofwat (2021) paper *PR14 Review: Discussion paper on findings, August 2021* a previous example of this variation from 2014 is cited: "companies' estimates of customers' willingness to pay for avoidance of sewer flooding ranged from £25,500 to £434,300 per property".

¹⁷ Highlighted for example in Ofwat (2020) PR24 and beyond: Our reflections on lessons learnt from PR19

¹⁸ This point is made by Sustainability First (2020) Water companies' use of customer engagement in their PR19 redetermination statements to the CMA, An Independent report for Citizens Advice, July 2020.

¹⁹ CCW (2021) Future consumer representation models – a discussion paper.

We heard widespread concerns, highlighted by water companies and stakeholders, about the lack of weight placed on customer engagement evidence in regulatory decision making (both by Ofwat and the CMA). Similar concerns have been raised in the context of Ofgem's RIIO-2 price reviews.

CCW have commented that whilst the volume of research increased, this was not necessarily matched by the same step change in influence²⁰. The CMA in its re-determinations continued to recognise the role for regulatory discretion and for a regulator to act on behalf of customers, even where this may be contrary to the findings of customer research. Under this view customer evidence is not determinative and alternative evidence is always weighed in the protection of the consumer interest.

"we consider that there are some areas where customers may not reasonably be expected to reach an informed opinion on the information, such as complex technical matters. Nor would customers necessarily be able to evaluate the difference between alternative plans. In some cases, customers may not have comparative information on other companies and in others the differences in the methods used by the various companies could also affect the ability to make comparisons" para 3.28

"More generally, we consider it the role of the regulator, whether the CMA or Ofwat, to take a view on the evidence available to it in the round when setting targets, which will include evidence from comparator companies and other sources not available to customers. We would therefore be concerned were expectations to be raised that customer evidence in and of itself should be determinative, in circumstances where other sources of evidence suggest an alternative approach could be more consistent with customer interests" para 7.66

CMA (2021) Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited price determinations Final report.

The lack of ability for customers to access comparator evidence was cited as an example of this need, alongside areas of regulatory methodologies judged to be complex or technical (for example the underpinnings for the cost of capital). In such cases as noted by CCWater (2020) there is a need for regulators to always explain why it would not be appropriate to take customer evidence into consideration (when assessing business plans).²¹

2.4 Evolving landscapes for customer engagement

As well as addressing the lessons from PR19 in water there is also a need to consider the evolving landscapes for customer engagement more widely.

We summarise below what those appear to be for water, but set in the context as well of emerging trends more broadly and evidence of responses and developments in other regulated sectors.

EMERGING TRENDS

From a customer engagement and research perspective, four notable trends have been identified:²²

- *Environmental issues.* Awareness is shifting towards choices or a least an understanding that choices have to be made to address key environmental concerns. A challenge in the years ahead will be maintaining levels of public support for taking action on the environment when people are personally impacted financially and in their lifestyle choices.

²⁰ CCW (2020) CCW's View on Consumer Engagement at PR19: What worked well and how to build on this.

²¹ CCW (2020) Lessons learned from the 2019 Price Review. A Report by the Consumer Council for Water, p. 24

²² Review 2021: Standout Trends. <https://www.research-live.com/article/features/review-2021-standout-trends/id/5093632>

- *Changes to working patterns* and the evolution of post COVID-19 workplace. The responses to the COVID pandemic are forcing adaptations across sectors and some of these may be positive or can be embraced as positive. For example, the notion of competition being pushed aside for the value of collaboration and sharing of ideas for a common goal.
- *Greater inclusion and diversity* – this can be viewed as relating to the post COVID landscape but also tapping into policy agendas like ‘levelling up’.
- *Technological innovation* – this grows the appetite and ability for companies to understand their customers “data” 24/7 and also shapes how consumers want to share their views and behaviours.

To these trends can undoubtedly be added even more recently the forecast from the Bank of England that the UK faces the biggest drop in living standards in 30 years due to rising prices and tax rises.²³ This will add to the polarising effects of the COVID-19 pandemic on household finances.²⁴

RESPONSES AND DIRECTIONS IN OTHER REGULATED / PUBLIC SECTORS

Energy

Customer engagement in the regulated energy sectors has closely mirrored the evolution that has been observed in the water sector: the use of cost-benefit analysis to define service levels and outcomes, a role for Customer Engagement Groups to provide independent challenge and the use of deliberative engagement approaches to provide informed public views as an input to business plan development.

The incentives framework that Ofgem developed for RII0-2 closely aligns with the approaches Ofwat introduced at PR14. Cost benefit analysis combined with customer willingness to pay have been cornerstones of the approaches Ofgem has expected of energy wholesalers. Moreover, compared to Ofwat, in the more recent energy reviews approaches have been more closely aligned to the economic levels of service concept– balancing costs and benefits - as the basis for setting performance commitment levels.²⁵

The energy sectors have also replicated the water experience of using customer challenge groups, with very similar remits around challenging business plans and assuring stakeholder engagement processes. For example, Ofgem required as part of RII0-2 all electricity distribution network operators to set up Customer Engagement Groups (CEG) with the remit to scrutinise and provide on-going challenge to business plans for the 2023-28 period.

Northern Gas Networks established a public panel akin to a citizen assembly and this was considered to be a first for the energy sector.²⁶ The panel (recruited from a representative sample of customers) met over the period November 2018 to June 2019 and was used to enable customer and stakeholder groups to contribute to the development of the 2021-26 business plan. This approach reflected an increasing understanding that the public are capable of effectively engaging with complex and technical issues, when given time to learn, consider evidence, and balance up priorities before drawing conclusions.

Customer engagement in energy is also changing and is no longer just about the price and service performance to customers. Electric vehicle charging infrastructure, domestic solar generation and

²³ Bank of England (2022) Monetary Policy Report, February 2022.

²⁴ KPMG (2020) Responding to consumer trends in the new reality, November 2020.

²⁵ This somewhat contrasts Ofwat’s focus on upper quartile performance levels, see for example Ofgem, RII0-2 Sector Specific Methodology – Core Document, 24 May 2019

²⁶ Involve (2019) NGN Public Panel: Engagement Report, June 2019.

storage and the transition away from gas fired domestic boilers are now creating new avenues for customer engagement by energy companies in the sector. This also goes beyond the traditional engagement metrics relating to consumer protection, Guaranteed Standards of Service and affordability.

In addition to using co-creation and extensive stakeholder engagement around policy areas like net zero²⁷, there are attempts to develop a deeper understanding of how consumers interact with energy services in the widest sense. One example of this is Ofgem's recent user-centred policy making research related to electric vehicles. This covered from car purchase through installation of charging to buying energy, with a focus on identifying "pain points" so policy makers and market participants could look to address them.²⁸

Transport

Highways

National Highways (previously Highways England) works with Transport Focus, the UK's independent consumer watchdog for transport users and is monitored by the ORR who make sure national Highways meet their commitments to maintain and improve the road network, while meeting the needs of road users.

ORR monitors the performance of the roads and National Highways and advises the Department for Transport (DfT), the government body responsible for traffic and transport legislation, regulation and policies who agree how much funding National Highways receives.

Of note National Highways operates under a Licence Condition to consult with and take reasonable account of the views of its customers and stakeholders.²⁹ This covers:

- Local authorities and devolved administrations;
- Other transport network operators (including local highway authorities, Network Rail, port and airport operators);
- Operational partners (including, but not limited to, the emergency services);
- Road users;
- Local communities;
- Other relevant stakeholders with a significant stake in the long-term development of the network.

National Highways uses a range of approaches to understand the needs of customers and communities and to incorporate these into business plans. These approaches cover:

- Customer panels (domestic, professional drivers, freight & logistics)
- Dedicated customer feedback tool across customer touchpoints
- Online community engagement platform for all major schemes
- Customer segmentation and communities research

²⁷ BEIS and Ofgem (2021) Transitioning to a net zero energy system Smart Systems and Flexibility Plan 2021

²⁸ Ofgem (2021) Qualitative research with electric vehicle drivers to understand their needs and experience of the current user journey

²⁹ Highways England: Licence.

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/431389/strategic-highways-licence.pdf

National Highways also has a dedicated customer insight and behavioural change team with the remit to understand what highway users think, feel, say and do, and why. Understanding and *influencing* how people behave and how they interact in National Highway's physical and social environments is seen as central to delivering a safe, secure, sustainable and efficient transport system.

Aviation

In aviation, there is also evidence of Heathrow Airport attempting to understand customer interactions with the service in detail. Again, engagement to understand the customer journey is used to identify "pain points" for improvement³⁰. In a similar vein in the ongoing NR23 review NATS has for the first time sought directly to engage with passengers rather than just its airline customers.

Health and public sector

In the healthcare sectors the evolving engagement focus is on digital methods and development of customer-centric services.

Innovation is targeted at new technologies to better engage with customers on an ongoing basis/in real-time. Similarly, in the public sector generally, the developing focus is on quick, real-time research methods. A key driver of this is the pandemic disrupting a lot of services and engagement has shifted quickly to identify how to counter that. While the pandemic has presented many adversities, it has also introduced growth opportunities to enhance performance, leading to the acceleration of new customer engagement models and innovative methods to serve customer needs. Artificial intelligence has also been praised for being a key facilitating technology during the pandemic.³¹

OFWAT'S DIRECTIONS AND APPROACHES FOR PR24

Ofwat's recent publications, setting the scene for PR24 and beyond³², highlight the challenges facing water companies in the future, including adapting to climate change, rising environmental expectations and water poverty, especially in light of the impacts of the ongoing COVID pandemic. These all echo the trends and developments in other sectors noted above.

Ofwat has set expectations that companies PR24 plans consider the following four areas, which will all impact on company engagement strategies:

- Focusing on the long-term - companies should set out their five year plans in the context of a long-term adaptive delivery strategy.
- Focus on delivering environmental and social value. In part the expectation is this will be delivered through the increased focus on the long term. But also through partnerships and working with other stakeholders.
- Reflecting a clearer understanding of customers and communities day to day requirements from and interactions with water companies.
- Driving improvements through efficiency and innovation, including through the better use of data and markets.

On customer engagement Ofwat also refreshes its PR19 principles with a set of six customer engagement goals for how customer insight and evidence will inform the outcomes of PR24 and future price reviews:

1. Enable companies to take responsibility for their relationship with customers

³⁰ Arcadis (2018) An initial review of consumer interests in the development of the Heathrow Airport Limited Masterplan

³¹ <https://www.healthcareitnews.com/news/emea/health-system-future-will-be-consumer-centric-wellness-oriented-and-digitally-connected>

³² Ofwat (2021) PR24 and beyond: Creating tomorrow together, May 2021.

2. Recognise preferences so that price controls are tailored to the specific needs of customers and communities
3. Foster collaboration so we learn from each other when working to understand what matters to customers
4. Promote transparency so it is clear to all parties how customer evidence is being used in decision-making
5. Increase proportionality so that focus is on producing high-quality engagement instead of lots of it.
6. Broaden value so that companies understand people's views as citizens and their views as customers.

With the publication of Ofwat's recent consultations *PR24 and Beyond: Creating tomorrow, together*, and the subsequent *PR24 and beyond position paper: Collaborative customer research PR24*, the regulator has provided some direction for customer engagement at PR24. These directions appear to signal a shift of gears in two notable areas.

First, through its proposed centralised research Ofwat/CCWater will take hold of an element of the PR24 customer engagement that sat squarely with companies at PR19. This shift is to "fix" issues and concerns about the comparability of methods and valuations observed at PR19. These issues are not new and indeed were highlighted previously as far back as UWKIR (2010), which emphasised the benefits of comparability in customer valuation estimates.³³

The second change of gear is to alter the place for customer challenge *in the regulatory process* through non-mandating of customer challenge groups. Again, this shift is a response to a regulatory perception of weaknesses with the PR19 approaches.

In our view these intentional regulatory shifts could have undesired and unintended consequences.

These shifts could undermine the regulator's own goal (1) to enable companies to take responsibility for their relationship with customers. It shifts the balance around who articulates the customer voice and which voices are heard. A narrower scope for the centralised research does not undermine the need for companies to retain responsibility, but it may alter the balance.

It is unclear how the centralised research would (robustly) further the goal (2) of recognising preferences so that price controls (and associated incentives) are tailored to the specific needs of customers and communities. The benefits of comparability may entail a cost in terms of losing some local nuances.

Finally, without a clearly defined institutional role for customer challenge at a company level there would be less transparency - not more - and it would be less clear to all parties how customer evidence of assured quality is used in decision making. This impedes in our view Ofwat's PR24 goal (4) of promoting transparency.

2.5 Opportunities to be bolder?

In the rest of the report we use these learnings from PR19 and the evolving landscapes – broadly and within water – to address a broader set of objectives than those that Ofwat's appears to be considering through its centralised research. As well as addressing "What's wrong?", we see a case for asking "What's possible?"

Our answer to "What's possible?" is set out below in section 3 and section 4. We set out a recommended framework for customer engagement at PR24 and then explore options for how to incrementally evolve how the voice of at least some customers could be heard within the water regulatory process.

³³ UKWIR (2010) Review of Cost-Benefit Analysis and Benefit Valuation. Report 10/RG/07/18

3 Customer Engagement Evidence at PR24

This section of the report presents the heart of our recommendations on customer engagement for the 2024 price review (PR24) and beyond.

This section distils from our literature review and consultations, as well as our experience, a set of best practice principles that we recommend guide customer engagement. We discuss the areas where we think engagement should be focused and can provide greatest insight. A key part of this requires thinking about the new challenges for engagement at PR24 and beyond: what kinds of insights will be needed to help with meeting the challenges of the evolving PR24 landscape? We bring all of these considerations together into a proposed framework for customer engagement at PR24.

3.1 Principles for engagement

Throughout the project we have collated and reviewed a range of principles for customer engagement adopted by central government, other infrastructure organisations and their regulators.

We have combined this with the views gathered in interviews to synthesise our findings into the core objectives that we recommend underpin the customer engagement strategy. The 6 core principles we recommend bring together a range of thinking on best practice engagement and provide in some aspects a degree of further granularity to those already established principles:

6 Recommended Engagement Principles

- **Inclusive**
 - Plurality
 - *Listen to the full range of voices*
 - Subsidiarity
 - *Listen to voices as close as possible to those impacted*
- **Trusted**
 - *Engagement generates legitimacy through transparency and assurance*
- **Comprehensive**
 - *The customer is always relevant to some extent – however it is not always the driving force of decisions*
- **Meaningful**
 - *Engagement has a clear purpose, is of high quality and is easily understandable to respondents*
- **Triangulated (in its broadest sense)**
 - *Engagement ensures that all conclusions (whether policy or valuation) rely on more than one piece of evidence*
- **Evolving**
 - *Engagement builds on good practice, is open to innovative approaches and flexible to uncertain futures*

We elaborate on each of these principles below.

INCLUSIVE

Inclusivity features in most of the lists of principles we reviewed. It is clearly important in shaping public services such as those provided by water and sewerage companies that all interested parties are engaged. We have divided inclusivity into 2 sub-components:

PLURALITY – LISTEN TO THE FULL RANGE OF VOICES:

It is well known that the aggregation of preferences from a population of individuals to the community level will give no single answer to the question “what do our customers want”?³⁴. There will be a range of preferences and needs to be considered.

Identifying the range of voices that need to be heard is also important. We heard in our consultations of the need for more attention to wider stakeholder input in water, recognising that the perspectives and conversations going forward will be broader and deeper than a traditional customer perspective on water bills and services. More focus on specific groups and circumstances is also part of this.

“they are too narrowly focused on customer consumer, not enough focus on future consumer, not enough focus on citizen ... particularly around things like vulnerability where they’re starting to look at wider community vulnerability” Wider stakeholder/expert interview

“Energy’s got something which water I think hasn’t quite got really, which is there’s a concept in the energy sector called the worst served customer.” Wider stakeholder/expert interview

SUBSIDIARITY - LISTEN TO VOICES AS CLOSE AS POSSIBLE TO THOSE IMPACTED

Ofwat’s view has consistently been that companies “are best placed to develop a genuine understanding of customer needs and requirements” and a goal for PR24 is “enable companies to take responsibility for their relationships with their customers”. This restates a principle that has underpinned a lot of the engagement work undertaken by companies.

The principle of subsidiarity also reinforces the importance of companies being responsible for understanding and listening to their *customers*. This could now also be viewed more broadly to include the perspectives of wider stakeholders and communities as we have noted above.

TRUSTED

In regulated monopoly markets where customers have less ability to choose who supplies them, engagement serves as the vehicle through which legitimacy is generated.

“if you’re going to engage people, my strong feeling from a moral point of view, is if you’re going to involve customers in the process, then you should respect them. You don’t necessarily have to agree with them, but you can’t just dismiss them, because that will just undermine legitimacy.” Water Company Executive

Transparency and assurance are important elements to achieving legitimacy as this demonstrates that the voices of the engaged are being heard and listened to.

And I think [for] some of this, for the better companies... it’s about actually getting a bit of challenge into their companies. Wider stakeholder/expert interview

COMPREHENSIVE

Comprehensive engagement recognises that customer evidence can provide a useful input to the full range of business planning decisions required to determine the right outcomes at the right time and the right price. Heathrow Airport have adopted a principle to ‘consider consumer’s views across the full range of topics and on all aspects of the business plan, rather than pre-determining their priorities or seeking to endorse own priorities’.

³⁴ Nobel prize winning economist Kenneth Arrow’s impossibility theorem demonstrates this.

CCWater and others have questioned customers' ability to provide meaningful insight on technical issues such as financial building blocks, e.g. cost of capital.³⁵ In private markets, some customers view technical financing issues, particularly those where ethical issues come into play, as important in their purchasing choices. There is no reason to expect this to be any different for water and sewerage services - in fact, given the nature of the services, there may be more interest in these issues than for competitively provided goods. We heard counter opinions on this point in our consultations.

"I haven't seen anything which suggests to me, that customers, if engaged in the right way, cannot understand the cost of capital and everything else because they can reference the way they pay their mortgage or a car loan or whatever right?" **Water Industry Expert Interview**

These considerations should be tempered by:

- the need to ensure value for money - Ofwat's latest goals for customer engagement include increasing proportionality, focusing on quality over quantity.
- balancing the influence and value that customer insight brings to decision making with that of expert judgement. As noted most recently by the CMA:

*"The extensive engagement and research undertaken by companies in PR19 has gone a long way to encourage company business plans and regulatory decisions to reflect the specific priorities and values of customers and the outcomes framework is an area where customers and key stakeholders properly play a role in determining the standards of performance that companies should be held to account against. That said, we consider there are limits to the weight that can or should be placed on customer research evidence in this area, for example reflecting that customers have less information about comparator companies than the regulator."*³⁶

MEANINGFUL

There is lots of useful guidance from the MRS and CCW amongst others on making engagement meaningful. Meaningful engagement has a clear purpose, is of high quality and is easily understandable to respondents. In order to provide meaningful input complex issues need to be broken down and explained clearly in a way that enables customers to understand them. They need to know enough an issue to give an informed response or have the responses turned into measures that they can understand. Albeit, there are challenges to overcome in this respect:

"Our difficulty is going to be how would you educate the customer in the first place to try and understand that, to try and gain some real credible customer feedback to say these are the things that we think are important ... it's how to educate the customer ...in terms of how can they help us with some of the direction on where the investment needs to go and how we build up that portfolio of investment." **Water Company Interview**

TRIANGULATED

Triangulated engagement ensures that all conclusions (whether policy or valuation) rely on more than one piece of evidence. We heard loud and clear from all our consultations about the importance of triangulation in its broadest sense. As we noted above, it is not yet clear how the Ofwat/CCW centralised research will align with this principle.

The types of services provided by water companies have inherent unknowables due to network externalities and lack of revealed preference from markets. This lack of information means there is no single right answer for the level of water company services provided so means triangulation of

³⁵ CCW (2020) Engaging water customers for better consumer and business outcomes. Report by Blue Marble Research, April 2020.

³⁶ Competition & Markets Authority (2021) Anglian Water Services Limited, Bristol Water plc, Northumbrian Water Limited and Yorkshire Water Services Limited Price Determinations: Summary of Final Determinations. 17 March 2021. https://assets.publishing.service.gov.uk/media/604fa141e90e077fe7a5f45a/-/CMA_water_redeterminations_-_summary_-_online_version_---.pdf

evidence in its widest sense is vital for corroborated decisions. The more material the impact the more triangulation is required.

“triangulation in the kind of slightly more organic sense of taking a wide range of different perspectives and then reaching some conclusions that you can justify to a greater or lesser extent by an evidential base as to what you conclude about a particular set of issues there is a difference between this and what I would call formal meta-analysis” **Water Industry Expert Interview**

“A valiant effort was very much made, and I think that’s something the company is focussing on going forward. You know, all the bits of research they do, how does that form a broad and rich and deep picture of what customers are saying to them, what stakeholders are saying” **Water Industry Expert Interview**

EVOLVING

Evolving engagement builds on good practice, is innovative and flexible to uncertain futures. We heard clearly from all groups interviewed that engagement should not be one-off but continuous. This is also a theme that comes through in the literature and guidance³⁷.

“What should happen is understanding their customers on a continuing basis, what you're doing, some of that research will help input to the regulatory process as well.” **Independent utilities expert/commentator**

“If you had greater incentives to encourage the companies to understand on a continuing basis that would be good.” **Independent utilities expert/commentator**

3.2 What to engage on? The traditional regulatory building blocks

There is a broader question about where customer evidence, research and insight provides useful inputs to regulatory decisions. The context for asking this question is that regulators – in this case Ofwat and by extension the CMA – do not see customer evidence as binding on them. This reflects a view that – customer evidence is not determinative and alternative evidence is always weighed in the protection of the consumer interest.

We present below in

³⁷ CCWater (2020) Framework for Water Company Research

Table 1 a broad taxonomy of the regulatory inputs where customer evidence and insight has been developed. Often the initial need for this evidence is identified by regulators – as was the case with willingness to pay evidence.

Some areas are clear and we think are uncontroversial – those shaded dark green. The role of customer engagement in these areas is now accepted by both companies and regulators. Others are more recent expectations as an input to planning – shaded light green - and increasingly provide broad performance context for regulators as well as companies.

The orange shaded areas are the ones where there is more debate. For example, as noted above CCW has been of the view that technical regulatory areas are not fertile areas for conversations with customers. At the same time, we heard and acknowledge the opposing view that these areas should not be off limits to customers as it depends on how things are explained and presented. There also needs to be sensitivity to the possibility that customer engagement can be used to reveal a wish from customers to become better informed. An example of this was NWG’s own “Our Finances Explained” co-creation initiative.

Table 1: Engagement Taxonomy

Business Process	Activity/Building Block/Decision	Industry examples where customer engagement used at PR19
Regulatory Planning	Setting price limits Efficiency challenge RCV Fast/slow money Cost of capital	n/a Fair profits Bill profiling Small company premium
	Setting priorities Investment priorities – what & when Investment priorities – what & when	Priorities research Plan Balancing research
	Setting performance outcomes What are the performance commitments/measures? Levels of service Incentives	Willingness to Pay WTP/Bespoke research
	Setting bill-service trade-offs What is an acceptable change in bills? Affordability	Acceptability research Co-creation/Testing strategies
Business as Usual / Tracking	Monitoring customer experience Satisfaction Value for Money Incident responses Complaint handling	Tracking surveys Tracking surveys Tracking surveys Tracking surveys
	Education and behaviour influencing Behaviour change Information and messaging	Co-creation/focus groups Co-creation/focus groups

The key requirement – as expressed by CCW in its own PR19 engagement review - is that the thread between customer evidence, business plans and determinations needs to be clearer and more transparent. For example, where a regulator assesses a company's customer evidence as good (generally or on a specific issue) and then reaches a different decision then there is an equivalent onus on the regulator to explain such outcomes. In many of our consultations this absence of clarity and regulatory explanation was a frequent source of frustration. Moreover, as we explore in section 4, there are alternative regulatory processes available for translating customer wishes and preferences into agreements with regulated companies.

3.3 What to engage on? New challenges for engagement

Long term delivery strategies will be a central focus for PR24 and beyond.³⁸ This presents both challenges and opportunities for customer engagement.

It will be challenging. As Ofwat itself recognises it requires an understanding of what water customers/consumers/citizens want and expect from their water companies over the very long term which is intrinsically uncertain. This is precisely territory where some have argued – e.g. the Blue Marble 2020 report for CCWater – that customers can find it difficult to articulate meaningful views. At the same time, as we have documented above, the issue is more about the method of engagement.³⁹

The opportunity is that it will require developing different types of conversations with water customers and communities. These conversations will be more squarely about future long-term uncertainties, the challenges those uncertainties present to the delivery of water services and the longer-term choices that have to be made to secure resilient services in the face of these uncertainties.

The traditional five year regulatory plans now will now to viewed within these longer term delivery strategies; in other words nested. They are the stepping stones towards delivering a long term vision and Ofwat expectations will include assurance that the long term delivery strategy has been shaped by customer engagement.

5-YEAR PLANS NESTED WITHIN THE LONG-TERM STRATEGY

To meet these the new expectations we would define 5 tiers to the customer engagement required going forward:

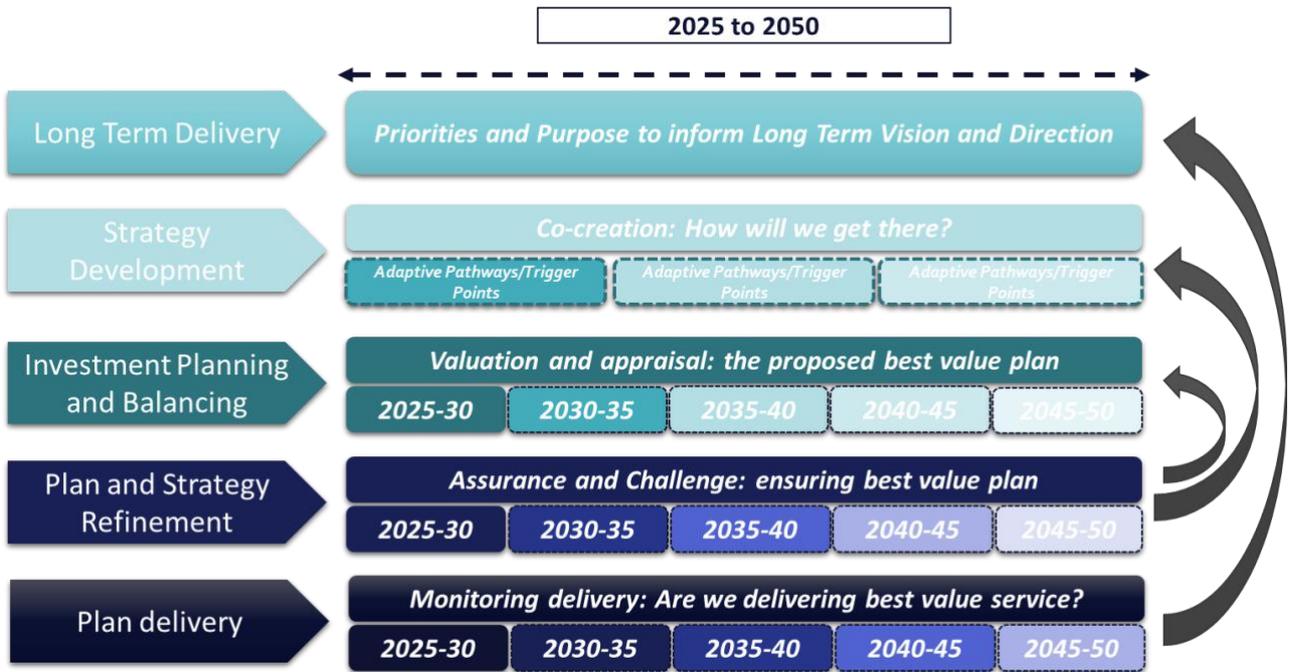
1. Long Term Delivery Strategy –Setting out the long term priorities and purpose
2. Strategy Development – How will or could we get there given future uncertainties? Drawing upon the principles of adaptive planning, what are the pathways to be identified?
3. Best Value Planning – Given 1. and 2. what are the best decisions over the next 5 years?
4. Plan and Strategy Refinement – Following testing and challenge, what plan refinements should be implemented?
5. Service delivery – Monitoring delivery to ensure best value service is being delivered. Capturing information to inform the direction and strategy for the future, which may include identification of any changes to underlying premises, data and preferences that would motivate adaptation of the delivery strategy.

And as emphasised above these tiers should be developed in ways that demonstrate coherence with this new nested concept. **Figure 1** provides a visual representation of where each engagement tier would fit within this nested planning framework.

Figure 1: Customer Engagement interaction with the long-term approach to planning

³⁸ Ofwat (2021) PR24 and beyond: Long-term delivery strategies and common reference scenarios, November 2021.

³⁹ For example, the Northern Gas Networks use of a public panel designed around deliberative sessions conducted over a period of time allowed customers to input on technical aspects of the business plan.



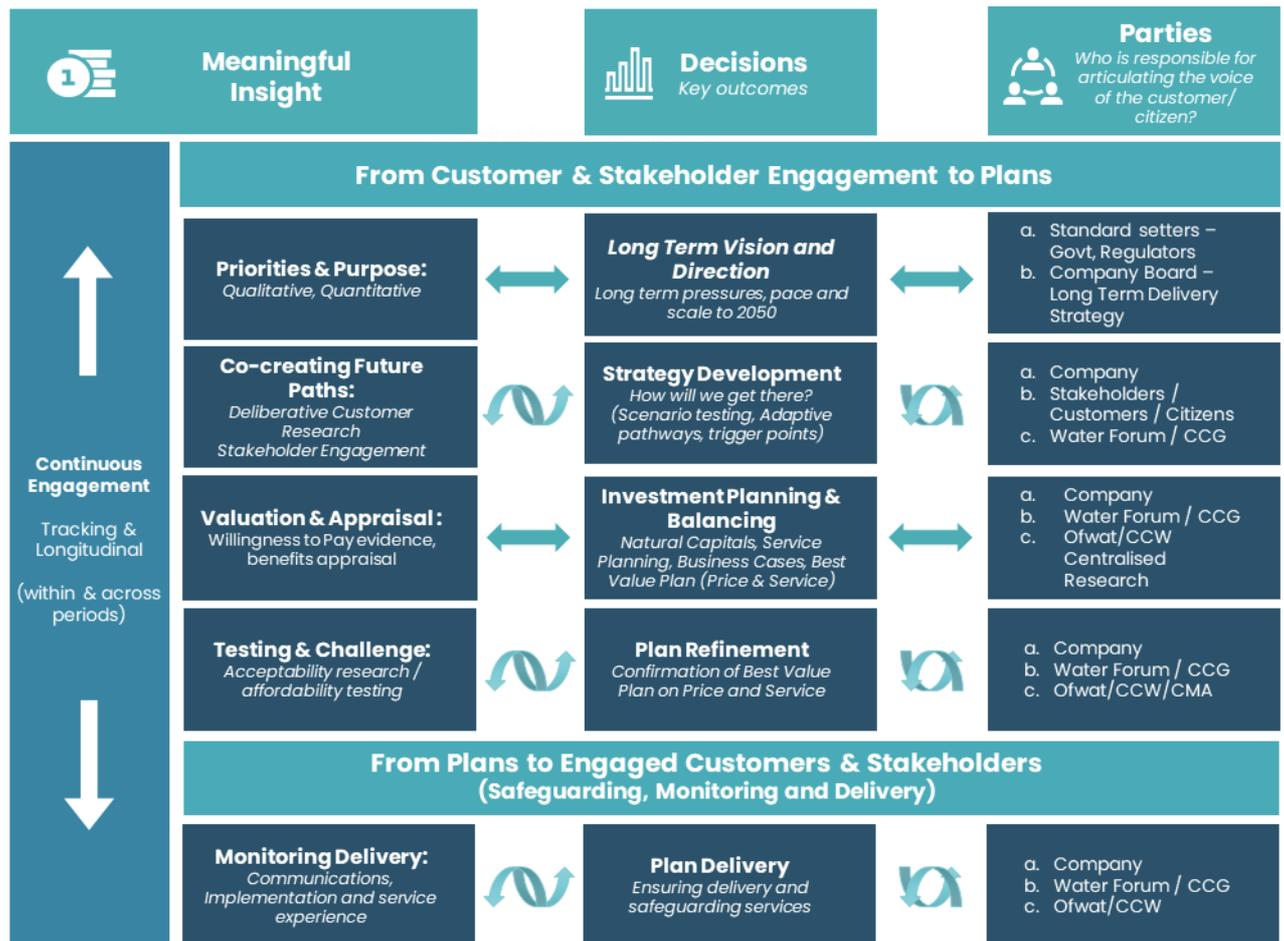
3.4 Evolving the engagement framework for PR24

The recommended framework presented below reflects the synthesis of our findings – both the desktop review and interviews. It is designed to demonstrate the link between customer engagement activities and business planning processes set in the context of long-term delivery.

The framework sets out 5 Steps to incorporate engagement into business planning and delivery.

The role of articulating the customer voice is multi-layered and shared across a number of organisations and stakeholders. A customer evidenced plan evolves by building each step on the previous, accounting for multiple feedbacks between the steps as well as incorporating ongoing engagement activities across the full timeline.

Figure 2: Proposed Engagement Framework



We elaborate below further detail on each of these steps.

STEP ONE: PRIORITIES & PURPOSE - DEFINING THE LONG-TERM VISION AND DIRECTION

Engagement in this step is focused on understanding purpose and priorities in order to determine the long-term company vision and direction.

The customer voice is heard and articulated through a multitude of layers:

- legislation and minimum standard setting at the national level incorporates customer and community views via government and regulators
- companies work with customers to understand and articulate their more detailed needs at the local level and to reflect more detailed customer views and to shape long term direction, balancing priorities. This would include in our view consideration of different packages of priorities and the bill pressures associated with those.

Engagement on priorities for PR24 and beyond needs to be framed explicitly within a long-term planning context to enable development of long-term delivery strategies – this is a theme that we heard clearly from all groups in our consultations.

Ofwat has stated that they expect any long-term objectives, over and above any statutory requirements, to be informed by customer views⁴⁰. Our consultations highlighted that this should go beyond understanding the priorities of solely the customer / bill – payer perspective and envisages

⁴⁰ Ofwat, 2021, PR24 and beyond: Long term delivery strategies and common reference scenarios.

engagement with served populations as citizens as well as customers – all groups also highlighted the need to engage stakeholders and communities in long term planning.

We also recommend as essential conversations with customers and stakeholders about long-term purpose and vision and exploring the trade-offs around the pace and scale of requirements within long-term delivery. Given the longevity of water industry assets, decisions made now have long term implications and need to be engaged on as part of developing adaptive strategies considering the affordability envelope and longer-term scenarios.

STEP TWO: CO-CREATING AND CO-DEVELOPING FUTURE PATHS

The purpose of engagement in step two is to develop long term strategy by co-creating and co-developing future paths with customers and stakeholders – i.e. the journey to deliver the long term vision.

The requirements of Strategy Development in our view are well suited to the insights that can come from co-creation and co-development methods.

Co-creation was used by a number of companies, including NWG, at PR19. Step 2 would extend this in ways that would be both new and challenging as part of informing the development of the strategy for both PR24 and longer-term.

The challenge here is the potential complexity of the issues – how to address the need for decision-making under uncertainty (covering climate change, technology, demand, environmental ambition). Ofwat has embraced the principles of long-term adaptive planning and the first step in that adaptive planning is to identify the alternative pathways and trigger points. Ofwat has stated that they ‘expect that companies use evidence of customer priorities and preferences to inform the selection and sequencing of enhancement investments for the core pathway up to 2050’. Whilst this can include valuation information set out in step 3 it should also aim to include wider engagement. CCW’s research into engaging customers for better outcomes stated that business plan inputs relating to very long-term planning and future scenarios was an area identified as least appropriate for consumer research⁴¹. Engagement, therefore, at Step 2 has to be on an informed footing.

Deliberative workshops, Citizen Assemblies / Panels, Expert Panels, Youth Boards all provide approaches and methods suited to the exposing of more complex issues that allow insight to be generated at the necessary informed level and also capture a suitable range of perspectives.

*“ think citizens assemblies or something like that are really quite interesting,because apart from anything else you’ve got the time for a dialogue with customers and which we don’t have in most research techniques...you’ve got to take them on a journey of conversation, and that’s where the citizens juries type things can be helpful.” **Water Company Executive***

*In principle, [citizens juries] could be one way of doing it. I mean, that’s real customers though, they are real customers who do citizens juries and you’re right, they hear evidence. You can do that, and I think that could be part of the process. But even if you don’t do that, I think the idea of having a purely customer focused group and if you like bringing these parties to explain their position and also to expose other information” **Independent utilities expert/commentator***

STEP THREE: VALUATION & APPRAISAL

This step covers engagement for valuation and appraisal to provide customer engagement evidence for planning balanced investment plans.

⁴¹ CCWater and Blue Marble Research, 2020, Engaging water customers for better consumer and business outcomes.

This step is about recognising where customer engagement can support more detailed plan development and balancing. This covers appraisal of monetary costs and benefits of solutions and the development of robust business cases.

The role of the company in articulating the customer voice remains key. However, PR24 will see an increased role for Ofwat and CCWater within this step with their proposed programme of centralised customer research. There remains a need to define more carefully the space occupied by this centralised research by virtue of its narrower service focus and also the limitation to the setting of core ODIs.

Different, if related, information from customer valuation evidence will also be needed as part of overall investment prioritisation by companies.

The plan balancing required at Step 3 ought to be underpinned by valuation evidence that allows the costs versus benefits of interventions to be understood. As well as the outputs provided by the Ofwat / CCW centralised research, this may require companies to carry out their own valuation activities to provide the full set of evidence needed to develop robust monetary benefits estimates. We would see this in line with the plurality, comprehensive and triangulation objectives for customer engagement.

STEP FOUR: TESTING, CHALLENGING & REFINING PLANS

The purpose of engagement in Step Four includes playback of what has been heard so far and how it has been used to test and refine plans.

The insight required here is a combination of customer (bill-payer) testing of the acceptability of the proposed business plan and the challenge provided by an independent body like a CCG. The latter is something that needs to be evident throughout Step 3 (Planning & Balancing) and Step 2 (Co-creating Future Paths) but its outcome is represented through the final milestone of plan refinement.

Acceptability will of course be primarily revealed through the proposed Ofwat / CCW centralised quantitative research for PR24. There remain opportunities, in our view, to sense check through company led research these findings with other methods, including slider tools and investment plan playback sessions and these can importantly be used to help shape revisions to plans. There is scope to use more traditional quantitative acceptability research earlier in the process to help shape an iterative approach to refining plans.

We also heard during our consultations that there can be value from understanding the perspective of the “worst served”.⁴² This is a regulatory requirement in the energy sectors that has no direct comparison currently in the water sector. Translated to testing the acceptability of plans this would align with trying to generate insights about the reasons for non-acceptance of plans.

As part of this step, it will be important to test the plan with uninformed bill payers. Testing with uninformed customers is an important recommendation of CCW to close the gap with informed customers who have helped build the plan. We also recommend testing checks are introduced with uninformed customers throughout the PR24 programme of research and not just at the end. Localised community testing may also be a feature of this step.

STEP FIVE: DELIVERY & MONITORING

Once plans have been agreed the focus moves to delivery. Engagement in this step is focused on monitoring and safeguarding delivery, together with how delivery is undertaken.

⁴² In energy “worst served” is defined with reference to a customer's experience of service interruptions. For example, a worst-served customer is one who experiences 12 or more higher voltage unplanned interruptions over a three year period, with at least three higher voltage interruptions each year.

The customer voice is key to both co-delivery and feedback on service implementation. There is an increasingly role for a body like the Water Forum here, as well as more traditional role for Ofwat & CCW.

A focus in this step is to use engagement to provide the insight to support flexibility to change within periods. Within five-year period this could focus on helping to redefine priorities within period. Within the adaptive planning step this flexibility extends to the medium-term strategies that underpin the long-term delivery objectives.

Ongoing community engagement is one of the three pillars identified by CCW in their Framework for Water Company Research⁴³. Community engagement includes understanding the best approach to delivering schemes and services and identifying opportunities during delivery for increasing environmental and social value. Extending the approach set out in step 2 will include the creation of partnerships and community Citizen Jurys/Panels.

CONTINUOUS ENGAGEMENT

A consistent theme we identified throughout the course of our review is that customer engagement should be designed to be more continuous rather than periodic or even one-off.

There is a clear role for continuous engagement to track views within and across periods. A message we heard repeatedly during our consultations is the importance of continuous engagement over periodic “plan” engagement. A key aim that CCW have identified is to use ongoing research and engagement to reduce the peak in research undertaken for business planning⁴⁴.

As the importance of five-year planning cycles become diminished, one-off engagement activities become less meaningful and useful. Rather, continuous dipping into the customer pulse becomes the focus and this affords the opportunity to bring the planning and business as usual customer insights together more closely.

3.5 Challenge and the role of CCGs

Ofwat’s position of no longer mandating a role for CCGs at PR24 affords companies like NWG the opportunity to pursue its own development of the challenge model it established at PR19 and has continued to expand and develop post PR19.

We found strong endorsement for NWG to continue to operate its Customer Challenge Group– the Water Forum. This reflects clear sentiment that the role of the Water Forum was fulfilled through PR19. The Water Forum was intimately involved in all aspects of the customer engagement programme and there was evidence that, without the Water Forum, elements of the NWG business plan would not have been progressed.

However, industry wide there was regulatory perceptions of weakness with the PR19 model. Based on evidence from our consultation, these perceptions are rooted in a number of concerns, specifically:

- asymmetry of information – information presented to the groups is primarily only available via companies therefore there is the perception that a balanced view may not have been available to CCGs when they made their assessments and challenge.
- linked to this some commentators queried whether Ofwat needs to be involved in the process to provide that balanced input.
- the ability to provide timely information given some of the turnaround times.

⁴³ CCWater, 2021, Framework for Water Company Research. The other two pillars are ongoing research and engagement to understand customers views (a mix of this step and the continuous engagement section) and business planning research (Steps 1 to 4 of our framework).

⁴⁴ CCWater, 2021, Framework for Water Company Research.

- absence of comparative information – due to the nature of the price review process CCGs and companies frequently do not have access to comparative data that allows the CCGs to compare the approach or data for the company they are challenging to other companies.

Our proposed engagement framework presented in this document embeds at all steps the importance of challenge and assurance through a body like the CCG/Water Forum. This builds upon the recent commentary and recommendations offered by bodies like Sustainability First (SF)⁴⁵ and also the proposals from CCWater.

Sustainability First

Sustainability First (SF) have looked at this question in their response to Ofwat's recent PR24 consultations. Drawing on their experience of water sector CCGs, the equivalent Customer Engagement Groups in Ofgem's RIIO-2 and a workshop with participants from the two processes they set out their views on the role of engagement.

Key points of relevance are:

- *New challenges need new models:* SF's view is the voices of customers and stakeholders will be more important than ever because the challenges cannot be fixed alone by grey engineered solutions. Customers and stakeholders will form part of solutions through behaviour change and partnership working. Therefore, factoring in challenge from these parties gives greater opportunities for success, **regardless** of regulatory requirements. This gives resonance to our embedding of a CCG type group in our 5-step framework.
- *Learning from energy* SF sees benefits from the recent experience in the Energy sector with the introduction of CEGs (Customer Engagement Groups). SF cite extending the CEG role to beyond assurance on the quality of engagement, and into how engagement was used in business planning. We would note there is direct evidence of this also being true of the NWG Water Forum at PR19. Crucially through an ongoing challenge process in energy SF believe the CEGs drove up the quality of business plans **ahead** of regulatory scrutiny. They felt this brought tangible benefits to all parties.
- *Clarity on roles and breadth of skill:* SF's strongly is of the view that at the outset the role of the CCG should be very clearly defined. They felt the ambiguity created by gaps in Ofwat guidance created problems for the regulator and in some instances undermined the work of CCGs. It will be important for the membership of any company CCG to have the right skills and perspectives within its membership. At PR19 in general these groups lacked for example economists/research specialists to scrutinise engagement and plans. Additionally, stakeholders could operate within the CCG structure to bring challenge on their area of expertise, for instance environmental protection or vulnerable customers.

CCWater

There is also a need to embrace some of the directions set out recently by CCW for a new approach to consumer representation.⁴⁶

Their preferred model is a local Consumer Panel, with Stakeholder Group and Central Oversight Group (COG). The primary motivation for this option is to overcome information asymmetries and to address the acknowledged weakness with the current CCGs that information is primarily only available via companies.

⁴⁵ Sustainability First (SF) are an independent think tank and charity focused on promoting economic, social and environmental wellbeing in public utilities including the water sector.

⁴⁶ CCW (2021) Future consumer representation models, June 2021. <https://www.cewater.org.uk/research/future-consumer-representation-models/>

Beneath the COG would operate a company Consumer Panel (of bill-payers and non-bill payers) and Stakeholder group (which is likely to include appointed subject area experts). It is this Stakeholder group that would be closest in spirit and letter to the current CCGs. This Stakeholder group would be expected to comment on issues relating to: Consumer Engagement and Research; large investment programmes; common and bespoke performance commitments (PCs) and outcome delivery incentives (ODIs); vulnerability, affordability, environmental issues and future customers.

Stakeholder and expert assurance have been an increasing and vital part of regulatory processes and this helps to articulate the customer voice and ensure it is heard.

Since the CCWater report Ofwat have confirmed the introduction of the Central Oversight Group (COG) as part of the PR24 process. The intention is to share information (including comparative data) and best practice with the local groups. There would also be some level of assessment of the local groups performance.

The establishment of the COG is, in principle, aligned with the OpenReach Monitoring Unit that was established by Ofcom to assess whether the new rules were being observed following separation in the telecoms sector.

Recommended directions for CCGs

It is clear from our desk-top review and consultations that retaining a role for an independent group like a CCG at PR24 should remain a vital part of the regulatory and business planning process. This should also evolve into challenge and scrutiny that is on-going and directed at both business planning and business delivery.

There are steps that need to be considered to mitigate any remaining perceptions of regulatory capture. Some of these steps will emerge naturally in our view through, for example, the developments noted above from CCW. The key areas for focus appear to be:

- Enhancing governance arrangements to demonstrate unequivocally such groups operate at arm's length from companies. This could include establishing an industry good governance code with assurance of adherence provided by independent members;
- Enhancing capabilities (and information). This could include sub-groups for specific areas populated with experts and ability to draw upon external advisors as well as a more diverse set of backgrounds for lay-members; and
- Enhancing representation to ensure that challenge comes from a representative body of customers as well as relevant local and/or national stakeholders.

4 From evidence to agreement: evolving how the customer voice could be heard

Engagement that is designed to assist with the challenge and refinement of business plans arguably echoes previous PR19 approaches – and was certainly evident with the Water Forum’s challenge of the NWG PR19 business plan - and recognises the customer voice as an *input* to decisions. It would not take the next step of empowering the customer voice to be part of reaching (formal) agreements with regulated companies and for these agreements to become part of the decision-making by regulators.

Such approaches have been evident and successfully applied elsewhere in the water sector (e.g. Scotland), with more recent trials of similar approaches in the energy sectors in Australia. In other sectors (e.g. aviation in the UK) there has also been willingness from regulators to go along with agreements that are viewed as being in passenger interests and also to encourage direct contracting even where there is some element of over-arching price and quality regulation.

Therefore, an extension under Step 4 of our proposed framework would be to consider ways to *empower* customers or consumer panels or local communities to be part of reaching agreement with the water company on defined issues.

4.1 Experiences from elsewhere

Havyatt (2021) observes that there is difference between consumer engagement and consumer agreement. Fundamentally, this difference is about the process through which views on customer / consumer priorities and preferences are articulated and how regulatory decisions are reached. The context for this observation is his review of recent experiences with trials of what he terms consumer-centric energy network regulation in Australia.

Havyatt (2021) documents the experience of the “*NewReg*” trial, which he suggests has led to a step-change in the Australian Energy Regulator’s (AER) approach to consumer engagement and how consumers’ responses to regulatory proposals through engagement can shape the acceptance of proposals. He documents how this trial involving Ausnet Services – the owner and operator of the largest electricity distribution network in the State of Victoria- adopted a new regulatory process modelled on ‘negotiated settlement’. Havyatt offers the insight that this trial approach demonstrated success in developing revenue proposals agreed between network businesses and consumers and generated outcomes that were superior to the traditional regulatory approaches (with no direct mechanism for agreement between the regulated company and consumer bodies).

The term ‘negotiated settlement’ is most usually associated with Professor Stephen Littlechild - the ex-electricity regulator – and he has published widely about his advocacy of this approach as a development to existing regulatory approaches in the UK.

At its core the idea - as demonstrated by the *NewReg* trial - is for regulators to step back, not determine all or part of price controls for which they are responsible. Instead, regulators should facilitate discussion between companies, customers & other parties to work out and agree an acceptable way ahead. The core concept is that of facilitating agreement between companies (supplier of services) and consumers (buyers / recipients of services). In a sense a process that attempts to replicate most directly a market style outcome by bringing the demand side of the market together with the supply side.

Another key input is for regulators to be ready to respect any agreement, subject to meeting their own statutory duties. This was written into the *NewReg* trial, but also a feature of much earlier experiences with this type of engagement model. For example, Littlechild cites the case of the CAA in airport regulation where:

*"Final decisions and responsibility in a legal sense will continue to rest with the regulator. But if an agreement can be better reached by the parties, the regulator is likely to **have a preference for it** (our emphasis), provided the regulator is satisfied that the agreement meets user interests overall and is consistent with its statutory obligations."⁴⁷*

During our consultations we also heard directly from participants about the experiences with the consumer agreement model developed in Scotland by the Water Industry Commission for Scotland (WICS). This was inspired by some of Stephen Littlechild's previous advocacy and was introduced ahead of the Strategic Review of Charges 2015-21 with a key innovation being the creation of the Customer Forum. The Customer Forum had the role of identifying customer priorities and then also engaging in direct discussions with Scottish Water over priorities for improvements in the costs and level of service. The WICS retained the role of providing expert direction to the discussions between the Forum and Scottish Water. The WICS final determinations incorporated the Minute of Agreement reached between Scottish Water and the Customer Forum in early 2014.

The subsequent review in Scotland – SRC21 – has recently concluded using the same agreement model. Independent commentators have drawn noteworthy comparisons with the outcomes of PR19:

"The contrasts between SRC21 and PR19 are stark, including in terms of planning horizon, price outcomes for customers, process and spirit (contrast the collaboration in Scotland with the acrimony at the Competition and Markets Authority in particular)."⁴⁸

The original role envisaged for the Customer Forum evolved enormously over the review period for SRC21, moving beyond having a say on price and service to customers to one that involved co-creating Scottish Water's strategic plan and generally playing a broader and deeper role.

"It's a huge change. There's probably no better example of the extent to which we've had to change the whole regulatory framework than the change in remit of the Customer Forum in this process."⁴⁹

4.2 What scope at PR24?

The examples cited above demonstrate three conditions are usually required to be in place for successful outcomes to an agreements approach:

1. An informed demand side (representing the customer interest);
2. A willing supply side (the company); and
3. A facilitating regulatory framework.

Any move in the direction towards *empowering* customers to be part of *making* decisions would need to recognise the notable step that this would represent for the regulation of the water sector in England and Wales. The first condition may only be present in some limited areas (at present). The second is not backed by any experience to date in England & Wales and the third is also lacking.⁵⁰

For these reasons successful implementation elsewhere provides no guarantees of success in a different sector and regulatory environment. However, the balance of those successes should motivate we believe proper consideration of the potential of these approaches and our recommendation is that they can be designed as pilot trials that can be included as part of the PR24 review process and then potentially built upon for PR29.

⁴⁷ Littlechild, S. (2020) Submission to the CMA on Ofwat Price Determination, 24 May 2020, p. 8.

⁴⁸ Spending for a rainy day: Interview with Alan Sutherland", The Water Report, November 2020

⁴⁹ Spending for a rainy day: Interview with Alan Sutherland", The Water Report, November 2020

⁵⁰ On the third pre-condition, Ofwat outlined its reasoning for not favouring this approach in Ofwat (2021) PR24 and beyond: Creating tomorrow together, May 2021.

We recommend any trials are kept focused and limited in terms of their overall contribution to price setting and also the extent to which they would require the creation of additional participants, frameworks and processes.

These trials could mirror previous examples such as empowering a constituted consumer panel or Forum to seek agreement with the company over a defined outcome or use processes like Citizen Juries (which could also encourage wider stakeholder input).

The key objective would be to identify the benefits and challenges of moving from *engaging* customers to *empowering* customers in the regulated water market in England & Wales.

With these criteria in mind our recommended candidate pilots would be:

- *Developer services* – this relates primarily to the charging rules and levels that incumbent water companies levy on developers for the connection of new developments to water and wastewater networks (covering site specific work and local network reinforcement work). This pilot could examine if there are benefits to empowering customers (in this case developers) to be part of decision-making on charging rules and levels and whether this could generate improved outcomes (including improved market contestability). There is evidence that current regulatory approaches in this area are seen by stakeholders as too complex⁵¹. Moreover, based on Ofwat's PR19 Final Determinations, income from developer services typically ranges between 1% to 6% of overall wholesale revenues for water and sewerage companies and the impact of any changes for end-customer bills is also correspondingly small.⁵²
- *Local enhancement projects* – NWG's experiences of both the PR19 process and subsequently the reference to the CMA testify to some of the tensions around the role of customer evidence in the specific area of enhancement schemes promoted to address local service risks and concerns that were not recognised in regulatory determinations. There is a tension here between what local representatives think represents good value and what a central remote regulator thinks represents good value.

This reveals a potential disconnect between decision-makers who are remote to the circumstances and not impacted (the Subsidiarity principle), compared to local communities who are or would be impacted but who are remote to the decision-making. Examining the potential to close this gap would be the objective of this pilot. A tailored version of the "Minute of Agreement" approach used in Scotland by the WICS, whereby evidence of such agreement in these local cases encourages a "minded to accept" position by the regulator.

Like with the experience of the recent "*NewReg*" trial in Australia⁵³, there could be benefits to limiting these trials to willing volunteer companies. The PR24 methodology could define the parameters of these pilots and invite willing companies to "opt-in". This would allow the pilot outcomes from the new processes to be compared with the "standard" PR24 approach.

⁵¹ CEPA (2021) Approach to the regulation of developer services at PR24, Final Report to Ofwat, 24 May 2021.

⁵² ICS calculations based on PR19 final determinations.

⁵³ Havyatt, D. (2021) Towards consumer-centric energy network regulation. https://www.researchgate.net/publication/355788901_Towards_Consumer-Centric_Energy_Network_Regulation

5 Conclusions

There has been enormous progress in the water industry since those early tentative first steps with customer engagement over 20 years ago. A great deal has been learnt about customers and embraced within water company processes and cultures. This has enabled companies to identify, justify and deliver enhanced services for their customers, communities, and the environment. The recent PR19 experience reinforces this progress with a continued expansion of both the volume and range of engagements.

However, through both our desk-top review and interview consultations, we have observed a feeling that the brakes are being put on this progress. These brakes are specifically creating uncertainty around how engagement, insight and customer research ought to be deployed to support business planning. There is a sense of waiting at the cross-roads and being unsure of which direction to take.

We conclude that there are two sets of factors providing the fuel behind this position:

- It is evident that engagement landscapes are changing and evolving across all sectors including water. Societal priorities are shifting (e.g. views about the environment), long term challenges and uncertainties are increasingly in focus (including recovery from the COVID pandemic) and digital technologies are increasing the range and nature of customer touchpoints. All of these will require and facilitate new types of conversations with customers and stakeholders.
- The recent regulatory direction has been to shift gears in two notable areas. First, through its proposed centralised research Ofwat/CCWater will take hold of an element of the PR24 customer engagement that sat squarely with companies at PR19. The second change of gear may be to alter the influence of customer challenge *in the regulatory process* through non-mandating of customer challenge groups.

In our view these intentional regulatory shifts could have undesired and unintended consequences. With these shifts it remains important not to undermine the regulator's own goal to enable companies to take responsibility for their relationship with customers.

It is unclear how the centralised research would (robustly) further the goal of recognising preferences so that price controls (and associated incentives) are tailored to the specific needs of customers and communities. As well as the outputs provided by the Ofwat / CCW centralised research, there will remain the need for companies to carry out their own valuation activities to provide the full set of customer evidence needed for overall plan development and balancing. We would see this in line with the plurality, comprehensive and triangulation objectives for customer engagement.

Without a clearly defined institutional role for customer challenge at a company level there could be less transparency - not more - and it would be less clear to all parties how customer evidence of assured quality is used in decision making. This could dampen Ofwat's PR24 goal of promoting transparency. It moves further away from the principle that 'every decision should be the one it would take if the customer were in the room'.⁵⁴

Our proposed engagement framework is designed to provide some direction at these cross-roads. It recognises that engagement needs to be tailored to work within the emerging PR24 framework, but also be able to respond to the opportunities and challenges presented by the need to inform the development of long-term delivery strategies and meet Ofwat's PR24 engagement goals. The framework identifies as related steps the five outcomes or decisions the engagement should inform. Namely:

- *Long Term Delivery Strategy* – Setting out the long-term priorities and purpose
- *Strategy Development* – Drawing upon the principles of adaptive planning, what are the pathways to achieving the long-term purpose?

⁵⁴ "Spending for a rainy day: Interview with Alan Sutherland", The Water Report, November 2020.

- *Best Value Planning* – Given 1. and 2. what are the best decisions over the next 5 years based on value to customers?
- *Plan and Strategy Refinement* – Following testing and challenge, what plan refinements should be implemented to align with customer views on price and service?
- *Service delivery* – Monitoring delivery to ensure best value service is being delivered. Capturing information to inform the direction and strategy for the future, including identification of any changes to underlying premises, data and preferences and flexibly to adapting the delivery strategy.

The framework is purposefully high level to allow each step to be tailored to individual needs and circumstances.

Evolving the directions for customer engagement will require different and potentially more challenging conversations with customers and stakeholders than have hitherto been the case in water. Our framework explicitly embeds the need for these conversations, while not constraining the opportunities for further development by companies to suit their own needs.

In the poetic words of Margaret Wheatley: “There is no power greater than a community discovering what it cares about....Be brave enough to start a conversation that matters. Talk to people you know. Talk to people you don’t know. Talk to people you never talk to. Be intrigued by the differences you hear. Expect to be surprised...”⁵⁵

⁵⁵ Extract from Margaret J. Wheatley (2002) Turning to one another. <https://margaretwheatley.com/books-products/books/turning-one-another/>

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Wessex Water, *Outcome Based Environmental Regulation: Enabling the water sector to make its contribution to the 25 year Environment plan* (2021)

Zoe McLeod and Roger Darlington, *How can the consumer voice be better heard in regulation of essential services?* (2015)

Appendix: Consultees

WHO

NWG suggested a programme of consultations comprising a mix of internal and external individuals and organisations.

We used this list of individuals as a starting point to develop a structured list of consultees identifying their affiliations, areas of expertise and experience and the areas / questions where they are expected to contribute.

We undertook a simple “gap analysis” to identify where we believe additions to the consultees would be beneficial.

While Ofwat were not included on the list of consultees, we saw merit to extending invitations to Ofwat to observe directly interviews / groups (along with any other organisations including NWG). This would provide a very direct means for Ofwat to hear the views of stakeholders and experts, specifically on issues around best practice and the approaches for PR24.

Ofwat declined to participate in this study.

The final consultation list is below.

Table 0.1: Schedule of consultations

Date	Time	Duration	Consultees
02/11/2021	17:00	0.45	Heidi Mottram, CEO
02/11/2021	11:00	0.45	Andrew Beaver, Regulation Director
01/11/2021	15:15	0.45	Louise Hunter, Corporate Communications Director
02/11/2021	13:00	0.45	Claire Sharp, Customer Director
05/11/2021	12:30	0.45	Harry Bush (External Assessor)
18/11/2021	12:00	0.45	Margaret Fay, iNED NWG
17/11/2021	14:00	0.45	Peter Vickery Smith, new iNED
01/11/2021	10:30	1.5	Strategic Engagement Team
17/11/2021	17:00	0.45	Tasmin Lisham NWG Asset Director
12/11/2021	16:00	1.0	Richard M and Will Robinson, NWG Asset Management Planners
5/11/2021	10:00	1.5	NWG Water Forum

5/11/2021	14:00	1.0	Graham Dale and Steve Grebby, CCWater Regional
26/11/2021	9:30	1.0	Mike Keil and Liz Cotton, CCWater National
10/11/2021	1.30	1.0	Stephen Littlechild, Alan Sutherland, Simon Oates
12/11/2021	14:00	1.0	Martin Hurst and Zoe McLeod, Sustainability First
17/11/2021	11:00	1.0	Tony Smith
19/11/2021	09:30	1.0	Tony Ballance, Cadent
17/11/2021	12:30	1.0	Kim Davis, Explain Research
23/11/2021	11:00	0.45	Jess Cook, National Energy Action
19/11/2021	14:00	1.0	Bernard Crump
19/11/2021	12:00	1.0	Darren Rice, Anglian Water
18/11/2021	15:15	0.45	Sue Lindsay, Wessex Water
16/11/2021	16:00	0.45	Anna Riddick, Welsh Water

METHOD OF CONSULTATION

Consultations have been conducted via Microsoft Teams video calls through a mix of “1-2-1” interviews and group sessions. This provided the benefits of face to face communication whilst allowing the sharing of visual materials if required.

All responses within interviews and sessions are treated in confidence with no quotations being attributed to individuals. This is important to allow participants to provide feedback and opinion in a candid fashion.

Topic guides were developed for the interviews with 45 minutes allocated to executives and a longer 1.5 hour topic guide for the remaining participants. Example topic guides are provided for reference in the appendix. The topic guides were then tailored for individual interviews.

Assurance

Document Assurance

Version	Author	Approval	Proof Read
1.0	Scott Reid / Amanda Markwardt	Melinda Acutt	Tim Young
2.0	Scott Reid	Melinda Acutt	Melinda Acutt
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ICS Consulting Ltd
Peartree House
Main Street
Little Smeaton
North Yorkshire
WF8 3LG

www.icsconsulting.co.uk