

25 May 2016

Trust in water

# Ofwat's customer engagement policy statement and expectations for PR19

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**Ofwat**

## About this document

This policy statement provides early guidance on our long-term vision for customer engagement in the England and Wales water industry and sets out the further improvements we expect to see at the next price review, PR19. We hope that, by providing clarity about our expectations at this early stage, companies have the time and space they need to work with the Customer Challenge Groups (CCGs) to develop and deliver effective and innovative customer engagement strategies for PR19.

This statement is published alongside our May [decision document](#).

This statement builds on and supersedes our 2011 customer engagement policy statement (['Involving customers in price setting – Ofwat's customer engagement policy statement'](#)).

## Contents

Executive summary	3
1 Introduction	6
2 Overarching principles of customer engagement	9
3 Roles and responsibilities	12
4 How we will take account of customers' views when considering company plans 34	
5 Next steps	36

## Executive summary

Our long-term vision is to put current and future customers at the heart of the way companies run their businesses. 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.

**Evidence** produced by the Institute of Customer Service (ICS) shows a positive relationship between the levels of service delivered and levels of customer trust. Putting customers at the heart of the way companies run their business is therefore crucial to delivering our overall vision for the sector that “Customers and wider society have trust and confidence in vital public water and wastewater services”.

The focus on customer engagement and outcomes was one of the 2014 price review's (PR14) key successes. It is an important feature we propose retaining for PR19. Companies, working closely with the CCGs, delivered a step-change in the quality and quantity of customer engagement at PR14. Stakeholders agree with our view that this is an area where companies should be striving to deliver a further step-change at PR19. This expectation will be reflected in the standards we apply to business plan quality in the risk-based review at PR19.

This statement sets out the roles that parties will play in PR19, which can be summarised as follows.

- **Companies** will be responsible for carrying out direct local engagement with their customers to understand their priorities, needs and requirements, which should then drive decision making and the development of the company's business plan.
- **CCGs** will provide independent challenge to companies and provide 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** will inform, enable and incentivise good customer engagement and will:
  - facilitate more CCG collaboration;
  - continue to provide information and clarity on our expectations (but not provide detailed or prescriptive guidance on how companies should engage with their customers); and
- strengthen our internal customer challenge by adding further customer expertise to the Water 2020 advisory panel.

Consistent with our statutory duties and strategy, we will intervene in business plans if we need to in order to protect customers or further our resilience objective.

The following summarises our decisions.

### **Role of companies**

Companies will continue to be responsible for engaging directly with their customers.

Each company will have in place a CCG for the 2019 price review (PR19).

To reflect our expectation that companies should aim to deliver further improvements in the quality of their customer engagement at PR19, we have set out a number of principles for good quality customer engagement. These principles provide clarity on our high level expectations; they do not prescribe in detail how companies should engage with their customers.

### **Role of CCGs**

CCGs will provide independent challenge to companies and independent assurance to us on: the quality of a company's customer engagement; and the extent to which this is reflected in business plans.

CCGs will submit an independent report to us at the same time as companies submit business plans (or parts thereof).

CCGs should focus on those issues that customer engagement is most likely to genuinely influence. We have provided more guidance on the issues that CCG reports should include and made it clear we do not expect CCGs to endorse a company's overall plan.

CCG membership should reflect local circumstances and challenges and include a representative from the Consumer Council for Water (CCWater). Chairs should not represent particular organisations or groups of customers. The environmental and drinking water quality regulators should play a significant role informing CCG discussions and CCG reports should highlight any concerns raised about the ability of the proposed plan to meet statutory obligations.

To build trust and legitimacy we would like to see an increased focus – by companies and the CCGs themselves – on CCG governance and funding process transparency.

### **Our role**

We will enable, inform and incentivise good quality customer engagement that puts customers at the heart of decision making. In keeping with our statutory duties and strategy, we will step in if required.

We will continue to provide clarity on our expectations regarding good quality customer engagement at PR19, including the roles that we, companies and CCGs have in delivering this.

We will host regular workshops with CCG chairs to facilitate the sharing of information, knowledge and good practice and help foster more CCG collaboration.

We confirm our commitment to publish early indications on the weighted average cost of capital (WACC) and outcome return on regulatory equity

## 1 Introduction

Our long-term vision is to put current and future customers at the heart of the way companies run their businesses. Unless otherwise stated, when we refer to customers, we are referring to end customers, that is, residential and business users of water and wastewater services. We not only expect companies to be responsible for engaging directly with their customers (as the companies are best placed to develop a genuine understanding of their needs and requirements), but also to use information from this engagement to drive decision making and provide excellent levels of service to all customers.

Successful companies in well-functioning markets, where customers are empowered and have choice over their supplier, will understand and respond to their customers' needs and requirements; otherwise they will go out of business. In regulated markets where customers do not have choice over their supplier, the regulator seeks to mimic the outcome of a competitive market by incentivising companies to genuinely understand and respond to the needs and requirements of their customers.

We acknowledge that understanding and responding to different customers' changing needs and requirements over time is not an easy task and requires significant commitment by the companies. Keeping up with increasing customer expectations about quality of service and the way in which services are delivered (for example, using social media) can also be challenging. But where this is successful, customers will really benefit by getting the service they want at a price that is fair and legitimate. This is integral to the delivery of our overall vision for the sector that "Customers and wider society have trust and confidence in vital public water and wastewater services". This statement explains how we will work with the sector to deliver this long-term vision and sets out our customer engagement policy for PR19.

The focus on customer engagement and outcomes was a key success of the 2014 price review (PR14) and an important feature that we propose to retain for PR19. Acknowledging the step-change in the quality of customer engagement already achieved by companies and CCGs at PR14, stakeholders agree with our view that this is an area where companies should be striving to deliver further improvements at PR19. This expectation will be reflected in the standards we apply to business plan quality in the risk-based review at PR19.

We appreciate the valuable contribution made by stakeholders as we developed our policy. This statement has been informed by responses to a number of reports published since PR14, including:

- the Consumer Council for Water's (CCWater) lessons learned from PR14;

- the papers companies published via the 'marketplace of ideas';
- various reports produced for United Kingdom Water Industry Research (UKWIR); and
- our own Water 2020 publications.

This statement supersedes our previous Statement published in 2011 (['Involving customers in price setting – Ofwat's Customer Engagement Policy Statement'](#)), which we refer to as 'the 2011 Statement on customer engagement'. Building on that statement, this document reflects on the successes and the lessons learned from ['PR14 -Reflections on the price review – learning from PR14' \(July 2015\)](#). It also sets out the improvements to customer engagement we expect to see at PR19.

We will need to consider more detailed questions of policy and methodology in the November 2016 consultation on outcomes and the July 2017 consultation on the regulatory methodology for PR19. For example, we will need to consider in more detail the methodology for assessing business plan quality in the risk-based review for PR19, including in relation to customer affordability. We are very mindful of the difference between providing clarity on our expectations and being prescriptive. We intend to provide clarity rather than prescription, which could inadvertently shift the focus away from customers and back to the regulator, undermining innovation that could have benefited customers. We hope that by being clear on our overall customer engagement policy for PR19 at this early stage in the review, companies have the time and space they need to develop and deliver effective and innovative customer engagement strategies for PR19.

Customer engagement needs to be considered in the context of wider changes taking place within the sector and the evolution of the regulatory framework.

- Our reforms, as outlined in the May [decision document](#), intend to make greater use of wholesale markets in sludge and water resources.
- All business customers of water companies whose areas are wholly or mainly in England will be able to choose their retailer from April 2017. The Welsh Government does not currently intend to extend competition to all business customers of water companies whose areas are wholly or mainly in Wales.
- We have also been asked by the UK Government to assess the costs and benefits of extending choice to the residential retail sector in England and we will publish our findings in summer 2016. The residential retail review does not consider Wales.

At present, many of the changes are in their infancy and wholesalers engage with most of their end-customers on full end-to-end delivery of water and wastewater



services. We do not want wholesalers to lose this link with their end customers, irrespective of structural changes in progress or under consideration.

There may, over time, be a change in the level of control some companies have over the issues on which they engage with their end customers. We expect them to play their part in providing the appropriate and necessary context when framing their engagement<sup>1</sup>, and to ensure that they continue to engage on the opportunities, issues and challenges where they have any role to play<sup>2</sup>. In due course, companies will need to consider if and how they could engage with retailers or other parties to help them gain additional relevant customer insight.

Where customers have choice, there should ultimately be less need for price and/or service quality regulation.

If retail competition is introduced for the residential retail market in England, we will need to consider what this means for price and/or service quality regulation and the implications for customer engagement. This would include considering the need for any ongoing expectations around customer engagement in the transition to a well-functioning market. The decision on introducing competition in the English residential retail market resides with the UK Government, and we do not propose to consider this further until it makes a decision. At present, we expect wholesalers to engage with their end-customers on all aspects of the service delivery, including on retail services.

All business customers of water companies whose areas are wholly or mainly in England will be able to choose their retailer from April 2017. There is a range of work going on to support this, including setting a retail price control and introducing a Code of Practice for the protection of business customers. Within this context, we consider it appropriate to let retailers serving business customers that have choice over their supplier develop their own customer engagement strategies, and not to introduce any additional requirements or expectations at this time.

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<sup>1</sup> This includes circumstances where end customers receive their water and wastewater services from different providers.

<sup>2</sup> In taking forward this engagement with end customers in the business retail market in England, companies will want to ensure they are acting in accordance with our [compliance code guidance](#).

## 2 Overarching principles of customer engagement

### 2.1 Principles from the 2011 Statement on customer engagement

The 2011 Statement on customer engagement identified seven principles of good customer engagement.

#### **Principle 1**

Water companies should deliver outcomes that customers and society value at a price they are willing to pay.

#### **Principle 2**

Customer engagement is essential to achieve the right outcomes at the right time and at the right price.

#### **Principle 3**

Engagement should not simply take place at price reviews. Engagement means understanding what customers want and responding to that in plans and ongoing delivery.

#### **Principle 4**

It is the companies' responsibility to engage with customers and to demonstrate that they have done it well.

#### **Principle 5**

Customers and their representatives must be able to challenge the companies throughout the process. The engagement process should ensure this challenge happens. If this is not done effectively, we must be able to challenge on customers' behalf. In doing so, we will fulfil our duty to protect customers.

#### **Principle 6**

Engagement is not a 'one-size-fits-all' process, but should reflect the particular circumstances of each company and its various household and non-household customers.

### **Principle 7**

The final decision on price limits is entrusted to Ofwat. We will use a risk-based approach to challenge company plans if this is necessary to protect customers' interests.

These principles remain fit for purpose. The focus on outcomes (principle 1) and customer engagement (principle 2) were two of the successes of PR14 and we will continue to focus on these areas at PR19.

Engagement is a continual and ongoing process and should not simply happen at price reviews (principle 3). We continue to emphasise the importance of this below, where we set out additional principles specific to direct customer engagement by companies (in section 4.1).

Companies are best placed to understand and respond to their customers' needs and requirements (principle 4). This is why we do not want to place ourselves – or any other third party – directly between them and their customers.

We want to improve the strength of this customer challenge process (for example, by promoting and enabling more use of comparative information on company performance) at PR19 (principle 5).

We expect to see companies developing a robust, balanced and proportionate evidence base and we accept that a one-size-fits-all approach will not work for customer engagement (principle 6). The nature and type of engagement techniques used will need to reflect the individual circumstances facing different companies and customers. It will also depend on how the information is going to be used (for example, to understand customers' priorities, to inform decisions on investments or to set incentives). We build on this below, where we set out more principles specific to direct customer engagement by companies (in section 4.1).

As a regulator, we can inform, enable and incentivise good quality customer engagement that drives decision making and the development of high-quality business plans. Ultimately, it is for companies, working with their CCGs, to deliver this. However, consistent with our duties, we will step in to protect customers if necessary (principles 5 and 7).

## **2.2 Building on these principles**

Acknowledging the step-change in the quality of direct customer engagement already achieved by companies and CCGs at PR14, stakeholders support our view that this is an area where companies should be striving to deliver further improvements at PR19. This expectation will be reflected in the standards we apply when assessing the quality of company business plans in the risk-based review at PR19. To provide clarity on our high-level expectations about what good customer engagement should look like at PR19, we have set out a number of additional principles for good quality customer engagement below (in section 4.1). These principles provide clarity on our high-level expectations; they do not prescribe in detail how companies should engage with their customers.

### 3 Roles and responsibilities

Building on our approach at PR14, customers' views will feed into the price-setting process via a three-tiered approach:

- **Companies** will be responsible for engaging directly with their customers to understand their priorities, needs and requirements and using this information to drive decision making and the development of the company's business plan. Each company will have in place, and support, an independent CCG.
- **CCGs** will provide independent challenge to companies and provide 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. Their terms of reference will reflect this role and show the distinction between it and any current delivery assurance role against current business plans the CCG may already have in place post PR14.
- **We** will inform, enable and incentivise good customer engagement and will:
  - facilitate more CCG collaboration;
  - provide information and clarity on our expectations (but not provide detailed or prescriptive guidance on how companies should engage with their customers); and
  - strengthen our internal customer challenge by adding further customer expertise to the Water 2020 advisory panel, so we are appropriately challenged as we develop and implement our regulatory methodology for PR19.

Consistent with our statutory duties and strategy, we will intervene in business plans if we need to in order to protect customers or further our resilience objective.

In the following sections, we outline further how each of these roles will work.

#### 3.1 Role of companies

Companies will continue to be responsible for engaging directly with their customers; this is where ownership and accountability needs to sit. Companies are best placed to build the relationship, to develop a genuine understanding of their customers' needs and requirements, and to use this information to drive decision making and the development of their business plan. It is not for us to prescribe how companies should engage with their customers. However, we agree that we need to be clear on our expectations about what good quality customer engagement looks like at PR19, especially since we are expecting further improvements in this area. This expectation

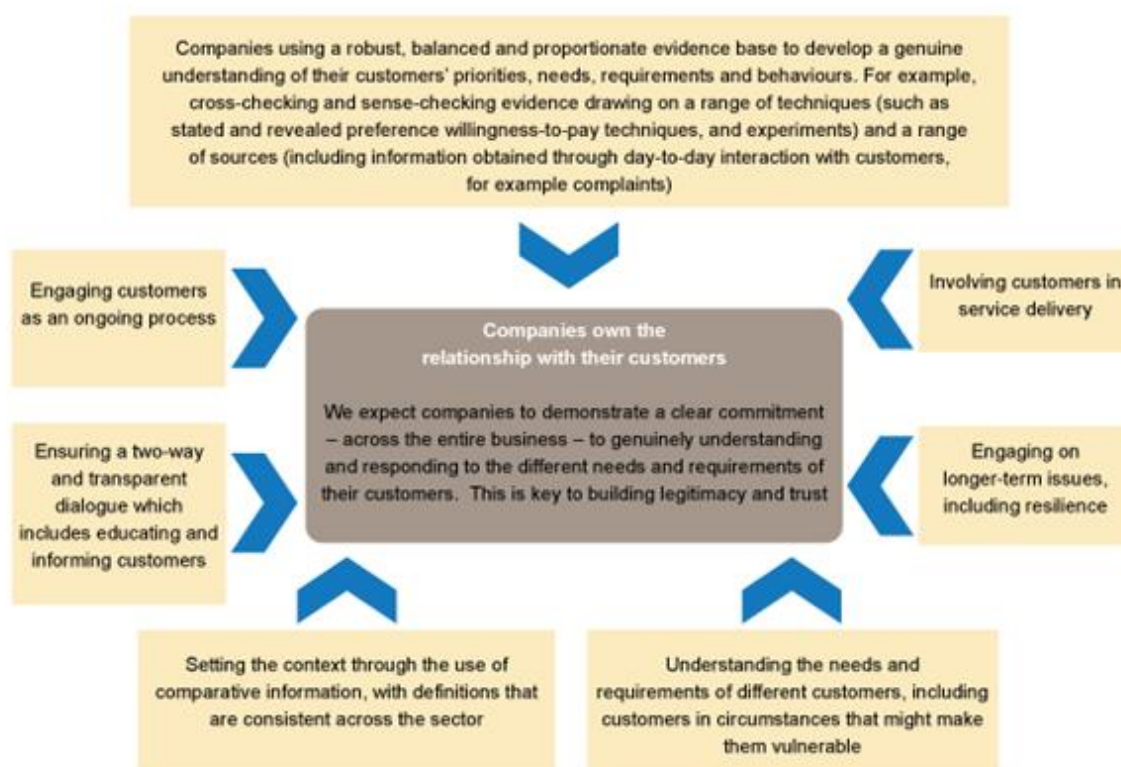
will be reflected in the standards we apply to business plan quality in the risk-based review at PR19.

Each company will be responsible for:

- designing and running its programme of direct engagement with customers and stakeholders, having regard to the principles of good quality customer engagement as set out below and in section 3.1 above;
- having in place and supporting an independent CCG whose chair acts in an individual capacity (rather than representing a particular organisation or group of customers). We expect companies to ensure chairs are recruited with sufficient capacity to dedicate the time required for the CCGs' role for PR19. We also expect companies will take appropriate measures to ensure good governance and transparency around the CCG and its independence (see section 4.2.3 below); and
- submitting a well-evidenced and independently assured business plan that reflects the priorities, needs and requirements of its current and future customers.

We have also built on – and refined – the overarching principles to set out additional principles for customer engagement that will apply at PR19. These are summarised in Figure 1.

**Figure 1: Additional principles of good customer engagement**

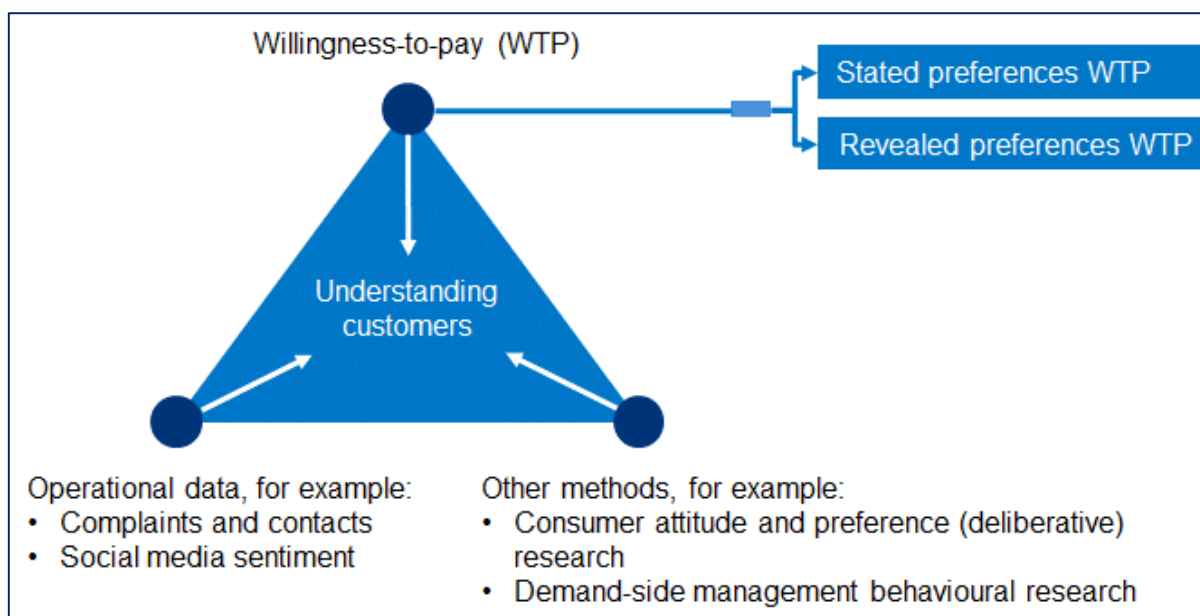


### 3.1.1 Using a robust, balanced and proportionate evidence base

In line with the position set out in our December consultation, we expect companies to place greater emphasis on building a robust, balanced and proportionate evidence base to genuinely understand their customers' needs and requirements.

While stated preference willingness to pay (WTP) approaches will continue to have an important role to play at PR19, it is also important for companies not to place sole or disproportionate reliance on such methods. We welcome the work that has been carried out by stakeholders around suggested improvements to stated preference WTP techniques. We also encourage companies to explore alternative and complementary tools to validate and test results from stated preference WTP surveys, and to make more use of evidence obtained through day-to-day contact with customers (such as from data generated through complaints, general contacts or social media). This also includes thinking about more innovative and frontier-shifting approaches to customer engagement, for example, by using revealed preference WTP techniques and experiments and by applying behavioural economics insights to the design and interpretation of the engagement. Figure 2 illustrates various engagement and research methods which can inform companies' understanding of customer priorities, needs, requirements and behaviours.

**Figure 2 - Understanding customers<sup>3</sup>**



At PR14, WTP information was required to develop performance commitments (PCs) and outcome delivery incentives (ODIs). We will consult on the proposed methodology for this in our methodology consultation (July 2017) but note customer valuations remain important and WTP information may still feature in this framework.

Quantitative and qualitative evidence on customer benefits have a role to play. To provide clarity, it is important companies develop quantitative evidence and do not move towards sole reliance on qualitative evidence. While qualitative evidence can supplement and support quantitative evidence on customer valuations, it is difficult to compare purely qualitative evidence on customer benefits with quantitative data on costs. For example, to make decisions on special factor cost claims for major capital programmes.

As companies look to draw insights and evidence from an appropriate range of data sources, research methods and experiments, it will be important to consider the proportionality of the customer engagement in relation to the impact of the findings. The insights gained from customer engagement will ultimately inform a number of elements of the business plan process<sup>3</sup> in the regulatory framework. The associated

<sup>3</sup> Customer engagement and research methods can be categorised, and visually represented, in many different ways. This figure merely represents one way of illustrating this. We encourage stakeholders to look at a United Utilities paper on 'Improving Customer Research and Engagement' published on the [Marketplace of Ideas](#). This includes a visual representation on 'Valuing customer priorities and involving customers'.



materiality and impact can help companies decide where and how customer engagement efforts are best spent. In doing so, we encourage companies to be proportionate in their approach so that the more significant the decision, the more robust the evidence base to support it. Also, as set out in the principles above, it will be important for companies to cross-check or triangulate findings against other data sources or research insights. Proportionality and triangulation will become even more important as companies start to explore new and innovative techniques or as they refine and improve existing or previously applied research methodologies.

### **Making progress and acknowledging innovation doesn't always work**

We are encouraged by some of the progress already being made on customer engagement and by the innovative ideas and approaches being considered or already in the planning stages. We welcome the extent to which stakeholders are starting to embrace the opportunity for innovation that is clearly manifesting itself. We encourage all parties to develop and start executing their plans, especially around more innovative approaches. With inherent uncertainties and likely setbacks as well as successes, it will be important to allow sufficient time for lessons to be learned. As time constraints and pressures build, the ability and willingness to explore and innovate will also likely be diminished.

Alongside the opportunities offered, there is an inherent element of risk in pursuing innovation. We expect companies, in building a robust, balanced and proportionate evidence base, to ensure the overall engagement plan will deliver the necessary insights. This may involve using more tried and tested approaches alongside more innovative ones. Even if an innovative approach is not (fully) successful, companies can still learn from this process and we would expect that to be reflected in the development of companies' business plans.

### **Playing our part**

Companies are responsible for engaging with their customers to understand their customers' priorities, needs and requirements. This is where the ownership and accountability sits. We want companies to engage effectively with their customers and to innovate, learn lessons and develop. We do not want to prescribe how this should be done and we welcome the work and collaboration by many parties that has already produced a range of materials and insights from which all can benefit. This includes the lessons learned around WTP research as conducted at PR14 and how this could be refined or improved. Such contributions are really valuable.

We want to play a constructive role, and in this spirit we already co-hosted a recent workshop on customer engagement alongside Water UK, CCWater and The Consultation Institute and Community Research.

We want to give companies the space to develop and execute their engagement plans, but we are open to conversations on the approaches being planned or adopted. At the same time, we need to be clear we will not be able to endorse any particular approach in advance of the risk-based review process leading into PR19.

### **Balancing incentives with sharing good practice**

There is a balance to strike between incentivising companies to engage and innovate effectively and achieving an appropriate level of sharing good practice. Companies' customer engagement feeds into the risk-based review, which incentivises them to provide business plans that best reflect customers' needs and requirements. We do not want to undermine any company's ability to perform well in that context and want a wide range of ideas to be explored. As such, we cannot and do not want to push or force companies to share innovative approaches – especially when such ideas are in their inception or early planning stages. Over time, at the very least once PR19 has reached its full conclusion, the approaches taken and lessons learned will emerge for all to benefit from, although we hope and expect it will not take that long. We consider that companies will start sharing ideas once they have progressed. We also expect companies will take pride in their progress and achievements, and will rightly use opportunities to gain recognition. Importantly, as regards customers in circumstances that make them vulnerable, we trust companies to do the right thing and share ideas and lessons if they have the potential to make a real difference to those customers<sup>4</sup>.

#### **3.1.2 Engaging customers as a continual and ongoing process**

Customer engagement is not a one-off exercise restricted to a specific time period in the run-up to a price review. It is a continuous process of learning and responding. Engagement in this context does not necessarily mean proactive contact or dedicated and targeted research projects. As noted above, a robust, balanced and

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<sup>4</sup> To broaden the understanding of customer vulnerability in the water sector in England and Wales, and to stimulate interest and debate around the issue, we published our '[Vulnerability focus report](#)' in February 2016. This report, published alongside a [Practitioners' Pack](#), identified a number of case studies and highlighted good practice related to identifying and responding to customers in circumstances that make them vulnerable.

proportionate evidence base will take account of operational data, and companies can consider how best to derive insights from business-as-usual interactions with customers. Continuous and ongoing engagement means being open to gaining customer views and feedback across channels, interactions and platforms, and can be driven by customers rather than necessarily being solicited by companies.

To some extent, the nature of the topic will dictate the type of engagement. There are issues on which it is appropriate, necessary and efficient to engage customers more extensively, more proactively or in a more targeted way. Others will lend themselves more to gaining insights from operational data and ongoing communications. Continuous engagement will also lend itself to better understanding of changing customer priorities and expectations and what drives such changes.

### **3.1.3 Ensuring a two-way and transparent dialogue**

We would like to see companies informing and educating their customers as well as seeking feedback from them.

There is a wide range of information and data available to companies from which customer insights can be drawn. For most customers, this will come from operational data (for example, consumption data), from customer contacts, or from customers sharing their views on social media. While we consider companies can get better at gaining insights from business-as-usual interactions, many of the impactful decisions to be made will still need to be based on more targeted customer engagement. The number of customers companies can have extensive, focused and targeted engagement with is far more limited. This forms part of taking a proportionate approach.

More extensive and targeted engagement involves a greater level of informing and educating customers. This is particularly relevant to companies' engagement on the resilience of their systems and services. For example, companies will need to improve customers' understanding of risk in order to test real customer acceptability of risks and costs. If well-designed, the insights and findings gained from such engagement can be largely representative of views of the wider customer base. As such, decisions based on that engagement should be ones the wider customer base could support. However, those customers who were not actively engaged may be unaware of this as they have not been through the informative engagement process.

It is therefore important companies do their best to ensure the wider customer base is informed about decisions that have been made and plans that have been

designed, including how the results of customer engagement have influenced these. This type of engagement can also be continuous and need not be limited to a one-off exercise at the end of a price review or at the start of a new price control period. The processes of engaging to learn and communicating to inform can run in parallel. This could in turn also stimulate a wider group of customers to provide views and feedback.

### **3.1.4 Understanding the needs and requirements of different customers**

It is essential to understand and respond to the distinct needs and requirements of different customers. This includes, for example, those in circumstances that make them vulnerable, (micro-) businesses and communities that may represent multiple customer segments.

We want companies to consider the different customer segments they serve, and ensure these are appropriately represented in the customer engagement process. This includes ensuring hard-to-reach customers, or those not fully digitally engaged, also have a voice. We encourage companies to think creatively and to learn from each other about how to engage the more hard-to-reach customers.

We acknowledge this is a complex area, especially as it relates to customers in circumstances that make them vulnerable. In February, we published our [Vulnerability Focus Report](#), which sets out a more dynamic definition of vulnerability and highlights approaches taken in other sectors, for example, in terms of identifying customers in situations of vulnerability. We want companies to consider how they can best understand these customers' needs and requirements. We also published our ['Affordability and debt 2014-15'](#) in December 2015, which provides important information about vulnerable household customers in England and Wales.

There is clearly a limit to how granular and how complex the customer segmentation should get. We want companies to consider which type and level of segmentation is needed, effective and proportionate to ensure their customer base is appropriately represented in the customer engagement process.

### **3.1.5 Engaging on longer-term issues, including resilience**

Good quality customer engagement will involve informing and engaging customers on longer-term issues. Resilience, security of services and long-term affordability of bills are examples of longer-term issues that matter to customers and society. In ['Towards resilience: how we will embed resilience in our work'](#), we set out the principles we expected service providers to follow to ensure the resilience of services

and systems for their customers now and in the future. Reflecting the importance of engaging with customers on this issue, one of the principles states that customer views should be at the heart. More generally, companies should ensure their plans reflect the needs and requirements of current as well as future customers.

We acknowledge this is a complex and challenging area. Individuals may also be affected as customers now, as customers in the future, or both. It may also affect future generations. Good quality information on resilience of systems and services and how they impact on customers and compare with service received by customers in other areas is likely to be important to effective engagement on resilience, as we discuss more generally below.

That said, a number of stakeholder agree with our view that it is possible to effectively engage customers on longer term issues. We expect companies to be creative in exploring ways in which customers can best be engaged on long-term issues and to consider the best ways to frame and interpret such engagement. Companies can consider the role they want customers to play when asking them to consider issues, decisions and plans, and explore if there is a meaningful way to engage younger audiences who will be future bill-payers.

### **3.1.6 Involving customers in service delivery**

We would like to see companies carefully consider how customers could help to co-create and co-deliver solutions to underlying challenges (for example, supply-demand imbalances), drawing on best practice in the water sector and other sectors.

Co-creation means companies are genuinely open to taking customers' views into consideration as they design their future service delivery. In other words, customer engagement should not be restricted to the internal development of plans to be tested with customers who decide on a preferred option. It means ensuring customers and, where appropriate, communities have a voice in the prioritisation of issues and the design of solutions.

Co-delivery means companies actively consider where customers and, where appropriate, communities can become part of the solution to specific issues and challenges. An obvious example of this sits with demand-side solutions to supply-side challenges.

### **3.1.7 Setting the context through the use of comparative information**

Finally, we also think it is important companies are transparent with customers about their relative levels of performance by using comparative information, with definitions that are consistent across the industry. We will publish a consultation on comparative information at PR19 in November 2016. We expect companies to use the comparative information that gets developed or published through that process.

Having comparative information available will allow customers to make more informed judgements about, for example, service levels and PCs (including any associated rewards and penalties) and should also facilitate more powerful challenge from CCGs. We acknowledge company representations on the importance of contextualisation of comparative information. It will be up to companies to appropriately frame such information and ensure customers understand any reasons or justifications underpinning performance on a particular comparative measure. Customers will draw appropriate conclusions from comparative information, providing this is effectively framed and explained. At the same time, we do not want companies to explain away differences that reflect genuine underlying inefficiencies or performance challenges. We expect companies to frame comparative information appropriately. CCGs will have an important role challenging companies and providing assurance to us that companies have made appropriate use of comparative information.

The principles for good quality customer engagement set out above are consistent with and reflect the second recommendation of the independent [Task and Finish Group on Resilience](#) – a recommendation it addressed to water companies and governments specifically – to increase public engagement and education. We recommend that water companies consider the relevant conclusions and analysis of this report when designing and implementing their customer engagement strategies.

## **3.2 Role of Customer Challenge Groups**

This section provides guidance on the role of the CCGs for PR19.

We are aware that all companies have retained customer groups after PR14 and that most of these are currently providing assurance on delivery of the PR14 business plans. For the purpose of this document, we are calling the groups CCGs, although we know they will be known locally by different names.

We have encouraged and incentivised companies to put in place robust assurance processes for reporting on their performance against business plans over the 2015-20 period. We recognise this incentive will be further strengthened by our decision to

consider in-period performance as part of the risk-based review at PR19. We have not prescribed in detail how companies should achieve this nor mandated that companies should have customer groups focused on assuring delivery of the PR14 business plans, which is for the companies and CCGs to agree. If CCGs are also providing challenge and assurance on the delivery of the PR14 business plans, the CCGs and companies will need to be mindful of and transparent about the fact that, going forward, the groups will be performing two distinct roles.

At present, the existing terms of reference for the groups are likely to vary and these will need to be refreshed – by the CCGs themselves to preserve independence – to reflect the role they will play at PR19, as set out in this statement.

**The role of the CCGs at PR19** will be to provide independent challenge to companies and independent assurance to us on:

- the quality of a company's customer engagement; and
- the extent to which the results of this engagement are driving decision making and are reflected in the company's plan.

CCGs are not a substitute for a company engaging with its actual customers and CCGs should not substitute their views for those of customers. There should be a clear thread running from customer priorities identified by the company's customer engagement through to the challenges the CCG makes and we do expect CCGs to challenge companies about how they have interpreted the results of their customer engagement.

We will require CCGs to provide an independent report to us when companies submit their business plans in 2018. We explain in section 4.2.1 below the questions CCGs reports should address. But to allow CCGs flexibility, this is not an exhaustive list. This report will provide us with assurance and valuable independent evidence that will inform our assessment of business plan quality as part of the risk-based review. We have considered the views of some stakeholders that CCGs should be allowed to submit their reports after companies have submitted their final business plans. But we think it is important the CCG reports and business plans are submitted at the same time, mainly because this should allow companies to respond to any potential issues raised by the CCG. Companies will need to ensure their final plans are available with a reasonable amount of time for CCGs to review before companies submit their business plans and CCGs submit their independent reports.

For those companies not achieving enhanced status in the risk-based review, we will require CCGs to submit a second independent report when companies revise their business plans (or parts thereof). This second report should focus on the changes

companies have made to their plans and will inform our decisions on company draft determinations.

### **3.2.1 Scope of CCG remit**

We agree it is important to clarify the scope of the CCG remit so the groups can focus their resources and effort on those issues on which they can add most value. Reflecting on various aspects of the previous price review (PR14), it became clear that additional guidance could allow some CCGs to be more focused and reduce the burden on members' time. However, we need to be clear about our expectations rather than producing prescriptive guidance, which could divert companies' attention from customers to the regulator.

Similarly, we should not be prescriptive about how the CCGs carry out their role. However, we will make clear those issues that can genuinely be influenced by evidence on customer engagement and those that are for the regulator to determine.

Evidence from customers should clearly influence a number of aspects of a company's plan including, but not necessarily limited to, company proposals on outcomes, PCs, ODIs as well as the affordability and profiling over time of bills. We expect CCG reports to cover these issues.

At PR14, we determined whether costs were efficient (including financial costs) and expect to do so again at PR19. We acknowledge that some stakeholders, including CCWater, the Environment Agency (EA) and Natural Resources Wales (NRW), think CCGs could effectively challenge costs in certain circumstances. While we would not expect CCGs to provide assurance that all costs included in a company's plan are efficient, we do not want to preclude them from challenging costs if they think it is appropriate and in customers' interests.

In our December 2015 consultation document '[Water 2020: Regulatory framework for wholesale markets and the 2019 price review](#)', we said we expect any special factor cost claims for major capital programmes to include customer engagement. This includes those relating to customer benefits associated with the range of plausible options that might be deployed to address the underlying programme need. This is consistent with our principle of involving customers in the design and delivery of solutions, for example, by seeking their views on alternative options and using this information to drive decision making. It will require companies to be genuinely open to responding to their customers' views, needs and requirements rather than consulting on a single preferred option. We have established the Cost Assessment Working Group to work with the industry to develop and refine data requirements



and our approach to assessing efficient costs and will set out our approach to assessing efficient costs in the price review methodology statement in 2017.

Companies are responsible for meeting their environmental and drinking water quality statutory obligations. Companies can still engage with their customers on the way in which they meet these obligations and, if appropriate, the options they have of meeting them, and customers may be willing to pay for improvements to the environment which go beyond the statutory obligations.

We do not expect CCGs to approve or endorse a company's overall plan. It is important that CCGs highlight areas of challenge and disagreement, including how the company has responded to challenges and any areas of outstanding disagreement. This is so we can have an honest commentary that informs our assessment of companies' business plans. It is also important the reports document how trade-offs have been explored and reflected in the development of the company's business plan.

We do expect CCGs to assess the overall quality of customer engagement and the degree to which the results of this engagement have been reflected in the company's proposed plan. The non-exhaustive list of questions below is intended to provide guidance on the issues CCG reports should address in their assessment. The CCG reports will inform our assessment of business plan quality in the risk-based review, so we encourage CCGs to include clear evidence to support the findings in their reports.

We want to emphasise that this list is not intended to be exhaustive and is not intended to constrain the scope of issues CCGs might want to cover in addressing the quality of the company's customer engagement and the degree to which this is reflected in a company's plan. It is vital CCGs have the flexibility to focus on those issues they think are most important.

#### **Non-exhaustive list of issues for CCG reports to include**

- Has the company developed a genuine understanding of its customers' priorities, needs and requirements – and where appropriate customer valuations – drawing on a robust, balanced and proportionate evidence base? Has the company engaged with customers on the issues that really matter to them?
- Where appropriate, has the company engaged with its customers on a genuine and realistic range of options? For example, in relation to a need to rebalance supply and demand, this might include increasing its own capacity, purchasing water from another company or demand management options. Where

appropriate, has the company considered how customers could help co-create and co-deliver solutions to underlying challenges?

- Has customer engagement been an on-going, two-way and transparent process, where companies are informing their customers as well as soliciting feedback from them?
- Has the company effectively engaged with and understood the needs and requirements of different customers, including those in circumstances that make them vulnerable? Has the company considered the most effective methods for engaging different customers, including those that are hard to reach?
- Has the company effectively engaged with its customers on longer term issues, including resilience, impacts on future bills and longer-term affordability? Does the business plan adequately consider and appropriately reflect the potential needs and requirements of future customers? Wherever appropriate, has the company engaged with its customers on the long-term resilience of its systems and services to customers?
- Has the company effectively informed and engaged with customers on its current levels of performance and how does this compare to other companies in a way customers could be expected to understand?
- Has the evidence and information obtained from customers (including through the company's day-to-day contacts with customers) genuinely driven and informed the development of the business plan to benefit current and future customers? What trade-offs (for example between different customers) have been identified and how has the company proposed to deal with these?

### **3.2.2 Membership**

Individual companies and CCG chairs should consider the appropriate membership of their CCG, which should reflect local circumstances and challenges facing residential and business customers as well as the demographic of their local supply area. CCGs should comprise a diverse range of stakeholders, as one of the benefits of a more diverse membership is that potential trade-offs are more likely to be identified and explored fully.

We support the appointment of CCG chairs to act as individuals and not as a representative of a particular organisation or group of customers so they can focus on their role of being a strong and independent chair.

Based on stakeholders' views, we maintain we should not prescribe CCG membership in detail. However we do expect CCGs to include a representative from CCWater and, if appropriate and possible, a representative from a debt-advisory

body. We also encourage CCGs to consider how smaller organisations such as charities can be involved without being unduly burdened.

## **Role of the environmental and drinking water quality regulators in the CCG process**

We think the statutory environmental and drinking water quality regulators (hereafter referred to as the statutory regulators) are crucial participants in the CCG process and we expect them to play a significant role informing CCG discussions at PR19. We are aware some of the smaller statutory regulators, such as the Drinking Water Inspectorate (DWI) and NRW, found that fully participating in the CCG process at PR14 was time consuming as it was in addition to other engagement on PR14 matters with companies and other stakeholders. It is clear from discussions with the CCG chairs that effective participation from statutory regulators is valuable and a significant contributor to the success of the CCG process.

We are also aware some statutory regulators are not participating in the groups currently, which are focusing more on providing independent assurance on PR14 performance. We acknowledge it might be difficult for a regulator responsible for enforcing performance standards to be part of a group providing assurance on performance. That said, we do not consider conflicts should arise in relation to the role of the CCGs for PR19. For the purpose of PR19, the groups will focus on providing independent challenge to the companies and independent assurance to us.

Companies are responsible for meeting their environmental and drinking water quality statutory obligations. At the last price review, the CCG reports included a section setting out whether the environmental and quality regulators thought the company had provided adequate assurance that it will meet its future statutory obligations<sup>5</sup>. We have listened to stakeholders' views and have engaged further with the EA, NRW, the DWI and CCG chairs. All agree that CCGs will work with these organisations to ensure they can contribute to the CCG process in the most effective and efficient way.

For the purpose of PR19, we expect the CCG report (either in the main body or through an annex) to include commentary on any concerns the CCG process has highlighted regarding tensions between delivery of the proposed plan and compliance with statutory environmental and drinking water quality obligations. This

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<sup>5</sup> (IN13/20 2014 price review – companies' compliance with statutory obligations).

information is extremely useful to our assessment of business plan quality in the risk-based review. It is very useful to understand if the environmental and drinking water quality regulators have raised concerns through the CCG process that a company's proposals put compliance with its future statutory environmental and drinking water quality obligations at risk. It is also very useful to understand if the relevant regulators have not identified or raised material concerns, or if these concerns have been raised and subsequently addressed by the company<sup>6</sup>. We recognise the ultimate responsibility to comply with legal obligations lies with the companies. And that the regulators' participation in the process does not mean they endorse the business plans, especially with respect to a company's compliance with its legal obligations.

## **The Wales Water Forum**

The Wales Water Forum was a successful means of engaging a range of stakeholders on water issues in Wales. Since 2009, the Welsh Government has established a separate forum specifically for price reviews. It enables key stakeholders to inform the development of water company business plans and ensures the proposals are endorsed by the Forum as being robust, fit for purpose, affordable and reflecting Welsh policy priorities.

The Welsh Government has confirmed it will be establishing a forum for PR19. The forum will write to Ofwat after the companies have submitted their plans, either to highlight they are content from a policy perspective or to highlight the positives and negatives of the process, as appropriate. We think this forum will also have an important role informing relevant stakeholders about the Welsh Government's legislative requirements and policy agenda. For example, the Wellbeing For Future Generations (Wales) Act 2015, the Planning (Wales) Act 2015, the Environment (Wales) Act 2016 and the National Policy Statement in 2017. The Welsh Government has confirmed it would not want the PR19 Wales Water Forum to become the only route for engagement with Welsh stakeholders, as many of the issues relating to the regulatory framework require more detailed discussions than would be possible through it. We expect the forum to complement rather than duplicate the CCG process at PR19.

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<sup>6</sup> We will not seek to undertake a review of the evidence that the environmental and drinking water quality regulators have analysed in reaching their assessments.

### 3.2.3 Governance arrangements and transparency

To build trust and legitimacy with customers and other stakeholders, we would like to see an increased focus on CCG governance and funding process transparency at PR19. We will take more assurance from CCG reports with stronger and more transparent governance processes in place.

Governance processes can include (but are not limited to):

- the appointment of chairs and members;
- the remuneration of chairs and members;
- any conflict of interests;
- support and other resources provided to the CCG;
- CCG access to non-executive members of company Boards;
- the expertise on the group; and
- the CCG process.

This is particularly important given the dual role groups may have over the next few years, as discussed in section 4.2.

It is reasonable CCG members – for example, chairs who do not represent a particular organisation – are remunerated, but we would like companies and CCGs to be transparent about the funding and governance processes adopted for the groups.

It is for companies to ensure their relationship with the CCG is at arm's length. This is so the CCGs can provide independent challenge to the companies and independent assurance to us. We will look out for this when assessing business plans in PR19. We do not want to prescribe particular detailed processes (for example, having particular organisations involved in the appointment of members or responsible for paying members); we would prefer to provide stakeholders with flexibility on how they meet the principles of independence and transparency. To be clear, we are likely to consider:

- how companies have recruited and remunerated particular members of the CCG;
- what other resources or information have been made available to CCGs, including comparative information on company performance; and
- what access CCGs have to non-executive members of the company Board.

We also expect companies to ensure chairs are recruited with sufficient capacity to dedicate the time required to fulfil their role.

The CCGs can also take measures to ensure they can act and are perceived to act independently and that this is transparent. For example, the CCGs can have their own web pages on the company's site which show:

- the membership of the CCG, how this was decided and a code of conduct on any conflicts of interests;
- its terms of reference, governance arrangements and ways of working; and
- minutes of meetings (anonymised if necessary).

We have agreed with the CCG chairs that they should refresh their terms of reference to reflect the PR19 role and clearly show the distinction between the roles. The CCG chairs confirmed they will do this with their members, independently from the companies. We encourage the CCGs to publish their revised terms of reference online.

### **3.3 Our role**

Our role is to inform, enable and incentivise good quality customer engagement that puts customers at the heart of decision making. To maintain the focus on customers rather than the regulator, we do not want to place ourselves – or any other third party – between companies and their customers. Once we have informed stakeholders about our expectations, published relevant information and developed appropriate incentives, it is for companies – working with CCGs – to deliver high-quality plans grounded in and accurately reflecting excellent customer engagement. But consistent with our statutory duties and strategy, we will step in if necessary. For example, we could intervene if a company failed to provide customers with information on their relative levels of performance or if companies were proposing financial rewards for performance that is not genuinely stretching. The submission of business plans by all companies will reveal information on how companies plans compare with each other in terms of PCs and costs. We will take account of this information in our assessment of plans and decisions on whether intervention is required. We appreciate CCGs will not have access to this information in their input on company business plans, although they will be able to take this into account in their view on any revisions to the company's plan.

The following section sets out the role we will have in more detail.

#### **3.3.1 Setting out expectations**

Consistent with our role as defined above, it is important we are clear with stakeholders about our expectations (as opposed to being prescriptive about what

companies should do to achieve these) at an early stage in the price-setting process. In this document, we have set out our high-level expectations about what good customer engagement should look like at PR19 (including our expectation that companies should be striving to deliver a step-change in quality compared to PR14). We have also explained the respective roles that companies, CCGs and we as the economic regulator have in delivering excellent levels of customer engagement that drives decision making. We hope that by being clear about our expectations at this early stage, companies have the time and space they need to work with the CCGs to develop and deliver effective and innovative customer engagement strategies for PR19.

### **3.3.2 Working with CCGs**

We will maintain regular contact with CCGs in two ways: through regular CCG chair workshops (see section 4.3.3 below) and through email communication with CCG chairs, updating them on issues or new developments.

### **3.3.3 Facilitating CCG collaboration**

To share information, knowledge and good practice between CCGs, we will host regular workshops with CCG chairs. These will also help ensure direct and regular communication between us, providing an opportunity to discuss relevant issues and developments.

We will hold workshops 3 to 4 times a year. To make good use of CCG chairs' time, we have planned these to be on the same day as the meetings they hold between themselves.

We will publish the presentations we use for these meetings on our website to ensure transparency.

We now have a page dedicated to [CCGs for PR19](#), which we will continue to develop as we move towards PR19, where CCGs and other stakeholders can find information about CCGs (for example, links to websites), slides used at CCG workshops and any information which will be helpful for CCGs to have.

### 3.3.4 Publishing information

Where possible and appropriate, we will continue to provide information and more clarity on our expectations earlier in the process to enable more effective customer engagement.

For example, we will set out our expectations on which commitments we expect to be common across the industry at PR19 in a consultation in November 2016 and will finalise in 2017.

We also think it is important companies are transparent with customers about their relative levels of performance by using comparative information with consistent definitions. Such information can empower customers and result in more effective challenges, including from CCGs. We are aware other organisations are currently working on this. For example, Water UK is working on the sector strategic dashboard. Reflecting progress made by these organisations, we will publish a consultation on comparative information at PR19 in November 2016.

We will publish early indications on the WACC and outcome RoRE ranges before business plans are submitted as part of the price review methodology statement so companies can take this into account when engaging customers and developing plans. As we will be publishing information on the WACC earlier than in previous reviews, it is important to note this is indicative only. We will retain absolute discretion to update the WACC where, for example, we consider it appropriate to reflect relevant changes such as market developments as PR19 progresses.

We will provide information on our cost assessment approach and cost-efficiency modelling, as part of the price review methodology statement, which could inform companies' development of their view of efficient costs to deliver business plans and items such as special factor claims. Information on companies' cost efficiency was made available at PR14 at various stages (following the risk-based review, draft and final determinations). Companies may want to consider sharing this information with their CCGs – alongside their efficiency performance in period.

As part of our company performance reporting work, we will also publish a single table setting out how each company is performing against each one of its PCs, updated annually. This will ensure all the publicly available information on company performance against the PR14 commitments and associated rewards and penalties is easily accessible.



### 3.3.5 Customer challenge and expertise in Ofwat

At the last price control (PR14), we established a Customer Advisory Panel (CAP). Its purpose was to challenge and provide advice to us on regulatory assumptions that affect companies' business plans and price limits and inform our decisions on methodology for the price review and subsequent determinations. The CAP was established to inform and advise us, but it did not take decisions about any aspect of the price review. It was valuable to seek challenge from the CAP as we developed the PR14 methodology. However, it was sometimes difficult to reconcile the PR14 timetable and milestones with the planned CAP meetings.

For the next price control (PR19), we would like to be challenged by customers on the development of our regulatory methodology and its implementation.

There are a number of ways customers can already add their voice and challenge the design and delivery of our methodology at PR19, including via:

- CCWater and other customer representative groups;
- the CCG chairs;
- the New-Pin<sup>7</sup>, which is aiming to build capacity in the water and energy sectors to ensure public interest is better represented; and
- the Water 2020 expert advisory panel. This will provide external expertise from a number of different fields (customer, investor, environmental, regulatory and academic) to help us develop and test our thinking on policy and practice issues relating to our Water 2020 programme.

We have decided to bolster the existing challenge routes by adding further expertise on representing customers in a regulatory context to our Water 2020 expert advisory panel. This approach will help embed customers at the heart of the programme. We will also be able to draw down on individual expertise at critical points, providing increased flexibility. While there are benefits to establishing a separate customer panel, adding further expertise to the existing panel can provide an effective and powerful challenge flexibly and efficiently.

We will also consider inviting customer experts from the Advisory Panel to our quarterly CCG chair workshops to increase transparency.

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<sup>7</sup> New Pin is the 'New energy and water public interest network' run by Sustainability first. It aims to build a stonger and more co-ordinated voice among customer, citizen and environmental advocates.

We do not want this process to duplicate the companies' own customer engagement, nor advise on or challenge individual company business plans. The focus will be on challenging and helping us develop and test our thinking on policy and practice issues relating to our Water 2020 programme.

## **4 How we will take account of customers' views when considering company plans**

We propose to link the quality of a company's customer engagement and the degree to which this is reflected in companies' plans directly to our assessment of business plan quality in the risk-based review. Our assessment will reflect our expectation that companies should strive to deliver further improvements to the quality of their customer engagement at PR19.

The independent CCG reports will provide valuable independent evidence that will inform our business plan quality assessment. While we do not want to prescribe the format or contents of the CCGs reports, we are providing more guidance on the issues we would like them to include so they can inform our assessment of business plan quality. Consistent with our legal duties and strategy, our assessment of business plan quality must be evidence based. As a result, the more evidence the CCG reports can provide (including evidence of robust challenge and how the companies have responded to this), the more informative to the assessment the reports will be.

For the purpose of PR19, we expect the CCG report (either in the main body or through an annex), to include commentary on any concerns the CCG process has highlighted regarding tensions between delivery of the proposed plan and compliance with statutory environmental and drinking water quality obligations. This will be particularly relevant to our assessment of business plan quality in the risk-based review.

To manage expectations, we confirm company performance in-period will count towards our assessment of business plan quality at PR19. We are aware companies will not be able to fully control external events that can adversely affect their business and performance. We acknowledge this and, in such cases, will be looking for evidence on how companies have responded to such events rather than ruling out the possibility of a company being enhanced just because they have experienced such an event.

Finally, we also expect to consider the CCG independence governance arrangements and will take greater assurance from CCG reports with stronger and more transparent governance processes in place.

As was the case at the last price review (PR14), we expect the quality of a company's customer engagement to be one aspect of business plan quality we will assess in the risk-based review. As a result, excellent customer engagement that is genuinely reflected in a company's plan is likely to be needed to gain enhanced

status, but is not the only factor required. For example, we would have concerns if customers are engaged on price-quality trade-offs that assume a level of costs we think is inefficient.

We will provide more information on how we propose to assess business plan quality in our risk-based review in the methodology consultation in July 2017.

## 5 Next steps

In this statement, we have set out our high-level expectations about what good customer engagement should look like at PR19 (including our expectation that companies should be striving to deliver further improvements to the quality of their customer engagement at PR19). We have also explained the respective roles of the companies, CCGs and the regulator in delivering excellent customer engagement that drives decision making. We hope that by being clear about our expectations at this early stage in the review, companies have the time and space they need to work with the CCGs to develop and deliver effective and innovative customer engagement strategies for PR19.

We want these expectations to remain valid up to and including the next price control (PR19) and we will seek to minimise any changes to the process set out in this document wherever possible. That said, customer engagement is likely to be influenced by some of the more detailed questions of policy and methodology for PR19 that we still need to consider. For example, it could be affected by our expectations regarding the balance of common and bespoke commitments and the role of comparative information, which are issues on which we will consult in November 2016. It could also be affected by the way in which we assess business plan quality, including in relation to customer affordability, which are issues on which we will consult in the PR19 methodology consultation in July 2017.

It is also possible changes in circumstances we cannot control may affect our expectations or agreed processes regarding customer engagement at PR19. For example, if the UK Government decides to introduce competition in the retail market for residential customers in England. If this happens, we will engage with stakeholders as soon as possible and update our expectations accordingly. Similarly, if it becomes apparent we need to clarify our expectations, we will engage with stakeholders as soon as possible.

We will continue to work with CCG chairs to provide the clarity they need to best fulfil their role for PR19 and we propose to produce a timetable for CCGs to show the key points of the process for their input.