

21 March 2018

Trust in water

# Aide Memoire for Customer Challenge Groups

[www.ofwat.gov.uk](http://www.ofwat.gov.uk)

**ofwat**

# Aide Memoire for Customer Challenge Groups

## Purpose of this note

In this note we provide Customer Challenge Group (CCGs) with an “aide memoire” of the following information:

1. The role of CCGs at the 2019 price review (PR19) as explained in the [May 2016 Customer Engagement Policy Statement and Expectations for PR19](#) (the “**Customer Engagement Policy Statement**”);
2. How we will take account of CCG independent assurance reports at the 2019 Price Review (PR19); and
3. The sections of [Delivering Water 2020: Our final methodology for the 2019 price review](#) (the “**Final Methodology**”) that are most relevant to CCGs.

This note supplements, but does not supersede, the Customer Engagement Policy Statement.

This aide memoire is provided to assist CCGs with performing their role at PR19. It intentionally summarises the information in the Final Methodology to make it easier for CCGs to follow. As a result it is not a full description of our policy as set out in the Final Methodology, including the Customer Engagement Policy Statement. The aide memoire does not prevent CCGs from looking at areas not covered in it, if the CCG considers this is necessary to perform its role effectively.

## 1. Role of CCGs at PR19

The information in this section summarises the Customer Engagement Policy Statement.

For the purpose of PR19, CCGs have a very clear role. This is 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 the company’s decision making and being reflected in the company’s business plan.

It is worth clarifying that CCGs can have two other roles. First, many CCGs are involved in reviewing and challenging companies' on-going performance, including their Annual Performance Report. Second, some CCGs are involved in informing the development of Ofwat policy through contributing to consultations and workshops. This is a role which we welcome, but it is not required of CCGs for the purpose of PR19.

This note focuses on CCGs' main role which is to provide independent challenge to companies and independent assurance to us for PR19.

The independent assurance will be provided in the form of an assurance report submitted alongside the company business plan to us on 3 September 2018. The assurance report will set out the evidence of how a CCG has carried out its independent challenge role.

CCG chairs should not represent particular organisations or groups of customers. Each CCG must include a representative from the Consumer Council for Water (CCWater).

We expect the environmental and drinking water quality regulators to play a significant role informing CCG discussions at PR19. Their role will include commentary on any concerns the CCG has highlighted regarding the company's compliance with statutory environmental and drinking water quality obligations, such as those set out in the joint Environment Agency and Natural England document "Water Industry Strategic Environmental Requirements" (WISER).

It is **not** the role of CCGs:

- to endorse a company's overall plan;
- to provide assurance that all costs included in a company's plan are efficient;
- to act as a substitute for a company engaging with its actual customers; or
- to substitute its views for those of customers.

Some CCGs might want to challenge company costs where appropriate and in customers' interests, but this does not form a part of a CCG's core role.

Each CCG should have terms of reference that reflects its role at PR19. The terms of reference should also show the distinction between the CCG's role at PR19 and any delivery assurance role against current business plans the CCG may already have in place.

## 2. How we will take account of CCG reports

As explained in the Customer Engagement Policy Statement, particularly section 4, there are two main factors that we will consider when taking account of CCG reports at PR19:

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

We discuss each in turn below.

### 2a) Evidence provided on how the CCG has carried out its role

The independent CCG reports will provide valuable independent evidence that will inform our assessment of business plan quality during our initial assessment of business plans (IAP) at PR19.

We 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. We set out a non-exhaustive list of issues, on which CCGs should include their views in their reports, at section 3.2.1 of the Customer Engagement Policy Statement. These are set out in the box below.

#### **Box 1 - 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?

Evidence from customers should influence many aspects of a company's plan including, but not necessarily limited to, company proposals on outcomes, performance commitments, outcome delivery incentives (ODIs), affordability, vulnerability, cost adjustment claims and the profiling of bills over time. In section 3 and annex 1 below we summarise the areas of the Final Methodology that are most relevant to CCGs. This includes the areas we explicitly ask CCGs to comment on as part of their reports and areas where we have asked companies to provide customer evidence to support their business plan proposals, which will therefore form part of the engagement that CCGs have to challenge and assure.

To avoid duplication of information between the company's business plan and the CCG's report a CCG can provide cross-references to evidence in the company's business plans in its report, where this is appropriate.

Consistent with our legal duties and strategy, our assessment of business plan quality must be evidence based. In this context, it is important that the CCG reports highlight:

- areas of challenge and disagreement, including how the company has responded to challenges;
- any areas of outstanding disagreement; and
- how trade-offs have been explored and reflected in the development of the company's business plan.

This is so that we can have honest commentary that informs our assessment of companies' business plans.

## **2b) Strength and transparency of governance arrangements**

CCG reports form an important element of our assessment of company plans, so we will need to have confidence in the CCGs' reports. The greater our confidence in the CCG report, the greater the weight we can put on its conclusions, irrespective of whether they are supportive or critical of company business plans.

To build trust and confidence with customers and other stakeholders, we have said we would like to see an increased focus on CCG governance and funding process transparency at PR19. We will take more assurance from CCG reports of CCGs with stronger and more transparent governance processes in place. Being able to demonstrate independence will play a role in the confidence we are able to place on the CCG report.

We set out our expectations in this regard in detail in section 3.2.3 of the Customer Engagement Policy Statement which includes:

- what the CCG governance process can (but is not limited to) include;
- what we are likely to consider to assess the independence of the challenge provided; and
- how CCGs can demonstrate transparency of the challenge process.

## Examples of good practice from PR14

We reviewed the positive impact of evidence from CCG reports on the price review process at PR14. We produced the following diagram of the lessons learned for discussion at our former Customer Advisory Panel on 9 May 2014. It provides some examples of good practice from the PR14 CCG reports.

**Figure 1 – Lessons learned from the PR14 CCG reports**



The six key pieces of learning were that we can be more confident in a CCG report and the views it expresses when:

1. It is clear that the CCG has been operating at arm's length from the company. For example, the CCG has held private sessions where its members can discuss issues without the water company being present;
2. The report relates to an area of expertise for the CCG and/or when the CCG includes expert members. For example, the views of a debt charity on the company's approach to affordability;

3. The CCG provides strong evidence for its challenges to a company. For example, clearly showing how its challenges relate back to customers' priorities;
4. There is evidence that the Board of the company was fully engaged with the CCG and responded to the challenges of the CCG members;
5. The CCG report provides clear statements of its independent assurance of the quality of a company's customer engagement and the extent to which the results of this engagement are reflected in the company's plan; and
6. The CCG focuses its challenges on the issues that we asked CCGs to provide a view on and it is clear from the report that the CCG understands its role and limits.

### **3. The sections of the Final Methodology that are most relevant to CCGs**

In annex 1, we bring together the sections of our Final Methodology document that are most relevant to CCGs. These include:

- a. Areas we explicitly ask CCGs to comment on as part of the CCG assurance report;
- b. Areas we have asked the CCGs to challenge companies on; and
- c. Areas we have asked companies to provide customer evidence to support their business plan proposals, which will therefore form part of the engagement that CCGs will have to challenge and assure.

Annex 1 contains three columns relating to the three areas above. The three columns relate to the wording of the PR19 methodology document. However, if there is not a tick in the first column, for example, a CCG can still comment on the issue, it is just that we have not explicitly asked the CCG to comment.



**Annex 1 - PR19 final methodology: areas where we have asked for the CCG to explicitly comment, challenge or have asked companies to provide evidence on customers' views**

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
<p><b>1. CCG role</b></p>	<p>Customer challenge groups (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.</p>	<p>n/a</p>	<p>n/a</p>	<p>n/a</p>	<p><a href="#">Delivering Water 2020: Our final methodology for the 2019 price review</a> (the "<b>Final Methodology</b>") - Executive summary and chapters 2, 13 and 14.</p> <p><a href="#">May 2016 Customer Engagement Policy Statement and Expectations for PR19</a> (the "<b>Customer Engagement Policy Statement</b>")</p>
<p><b>2. Customer engagement</b></p>	<p>Customer engagement will be a central part of the initial assessment of business plans. Customer engagement also provides essential evidence for companies' proposals in their business plans.</p> <p>In assessing the customer engagement test, we will take into account evidence including, but not limited to, evidence from its CCG.</p>	<p>✓</p>	<p>✓</p>	<p>✓</p>	<p><a href="#">Final Methodology</a> – Chapter 2 (whole)</p>
<p><b>3. Engagement with business retailers</b></p>	<p>We consider wholesalers should engage with business retailers as part of the customer engagement process to learn about their views and the views of their customers.</p>			<p>✓</p>	<p><a href="#">Final Methodology</a> – Chapter 2 (page 29)</p>

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
<b>4. Affordability</b>	<p>Companies are required to provide robust evidence in their business plans on how their approaches have, and will, deliver affordability for current customers, future customers, and those struggling, or at risk of struggling, to pay. This includes evidence on the customer engagement they have carried out on their approaches, how well the company understands what affordability looks like for its customers, and the customer support for the approach they have taken.</p> <p>Our assessment on affordability will be supported by evidence provided by companies, the independent reports from CCGs, and evidence from other expert organisations.</p>	✓	✓	✓	<a href="#">Final Methodology</a> – Chapter 3 (page 8) and <a href="#">Appendix 1</a> for more detail.
<b>5. Vulnerability</b>	<p>In our <a href="#">February 2016 Vulnerability focus report</a> we said that we would encourage CCGs to use the report as a base on which to challenge companies and their business plans when considering both customer service excellence and their companies' approaches to addressing vulnerability.</p> <p>In assessing the vulnerability test, we will take into account evidence that the company's approach to vulnerability is targeted, efficient and effective, including evidence from the independent CCG report.</p>	✓	✓	✓	Final Methodology <a href="#">Appendix 1</a>
5b. Vulnerability: bespoke performance commitment	We are requiring companies to include at least one bespoke performance commitment for addressing vulnerability in their business plans, after engaging with customers and taking on board challenges from their CCGs.	✓	✓	✓	<a href="#">Final Methodology</a> – Chapter 3

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
<b>6. Performance commitments</b>					
6a. General approach to performance commitments	CCGs will challenge companies on their approaches to setting performance commitments including how well they reflect customers' views and how stretching they are. Our assessment will include focussing on the CCG report.	✓	✓	✓	<a href="#">Final Methodology</a> – Chapter 4 (pages 45 and 53) and <a href="#">Appendix 2</a> (page 50)
6b. Setting stretching performance commitments	Our approach to setting stretching performance commitment levels for PR19 is that companies should: engage with their customers on their performance commitment levels; and challenge the level of stretch in their performance commitments with their customers, CCGs and other stakeholders.	✓	✓	✓	Final Methodology – <a href="#">Appendix 2</a> (page 50)
6c. Using multiple data sources for performance commitment levels (“triangulation”)	Companies will need to engage with their customers on the factors they take into account and will then need to explain how they have balanced these factors when setting their performance commitment levels using multiple data sources. The role of CCGs will be important in assuring how companies have engaged with their customers on this issue.	✓	✓	✓	Final Methodology – <a href="#">Appendix 2</a> (page 53)
6d. Setting initial service levels (2019-20) for performance commitments	At PR19 we expect companies to forecast appropriate initial service levels for 2019-20, and for these to influence the level of their performance commitments. CCGs will challenge companies on their forecasts for 2019-20, as well as their performance commitment levels.		✓	✓	Final Methodology - <a href="#">Appendix 2</a> (page 50)
6e. Common performance commitments	We expect companies to have four common performance commitments on asset health: mains bursts, unplanned outages, sewer collapses and treatment works compliance. This will enable customers, CCGs and us to		✓	✓	<a href="#">Final Methodology</a> – Chapter 4 (page 50)

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
	compare performance and challenge companies about their proposed levels for these commitments.				
6f. Bespoke performance commitments	<p>Companies have the freedom to engage widely with their customers and local stakeholders, to propose bespoke performance commitments that reflect their customers' particular preferences.</p> <p>There should be no, or very few, exemptions included in the definitions of bespoke performance commitments and any exemptions need to be well justified and supported by customers.</p>			✓	Final methodology – <a href="#">Appendix 2</a> (page 30)
6g. Abstraction Incentive Mechanism (AIM)	It is for companies to propose their AIM incentives, following engagement with their local stakeholders, and assurance from the CCG. Companies should identify suitable sites in liaison with the Environment Agency or Natural Resources Wales and provide evidence of their engagement.	✓	✓	✓	Final methodology – <a href="#">Appendix 2</a> (page 34)
6h. Leakage performance commitments	<p>We expect companies to explain how their five-year performance commitment levels and long-term projections for leakage take into account the views of their customers (with CCG assurance on how those views have been taken into account) and local stakeholders.</p> <p>Companies can make the case for leakage reductions that do not achieve our challenges above where they can provide robust evidence and a strong rationale for this. For example, that a company is already a frontier performer or has strong customer support not to reduce leakage to this extent.</p>		✓	✓	<a href="#">Final Methodology</a> - Chapter 4 (page 55) and <a href="#">Appendix 2</a> (page 66)

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
6i. Transparency of performance commitments	We require companies to explain in their business plans, how they will disseminate their performance information during the 2020-2025 period to customers, CCGs and other stakeholders.		✓	✓	Final Methodology – <a href="#">Appendix 2</a> (page 38)
6j. Scheme-specific performance commitments	A company should engage with its customers and CCGs on any scheme-specific performance commitments, as part of its engagement process on all its performance commitments.		✓	✓	Final Methodology – <a href="#">Appendix 2</a> (page 41)
<b>7. Outcome delivery incentives (ODIs )</b>					
7a. Consulting customers on ODIs	<p>We expect companies to develop their ODIs in consultation with their customers. CCGs will challenge companies on how well their proposed ODI outperformance and underperformance payment rates reflect a suitably wide range of evidence on their customers' preferences.</p> <p>Companies can propose outperformance payment caps and underperformance penalty collars on individual ODIs, if supported by their customer engagement.</p> <p>Our approach allows for a company to propose a reputational-only ODI, if the company provides convincing evidence that this is appropriate. This includes evidence from its customer engagement or that a performance commitment is not well suited to a financial ODI.</p>	✓	✓	✓	<a href="#">Final Methodology</a> - Chapter 4 (page 57) and <a href="#">Appendix 2</a> (pages 76 and 96)

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
7b. In-period ODIs	<p>Companies would need to justify, with evidence, why in-period ODIs are not in customers' interests, including why future customers should pay for/benefit from incentives related to the service performance affecting current customers. The evidence should include customer research and the views of the CCG on the quality of the research and how well the company has taken it into account.</p>		✓	✓	<a href="#">Final Methodology</a> - Chapter 4 (page 61) and <a href="#">Appendix 2</a> (page 81)
7c. Setting ODI rates	<p>CCGs will challenge companies on how well their proposed ODI outperformance and underperformance payment rates reflect a suitably wide range of evidence on their customers' preference.</p> <p>Companies can base their ODI outperformance and underperformance payment rates on the existing formulas, but amended, so that companies can use alternative customer valuations instead of only marginal stated preference WTP.</p> <p>Companies can use other customer evidence to propose changes to the ODI outperformance and underperformance payment rates calculated according to the existing formulas, provided the changes are well justified.</p>		✓	✓	Final Methodology - <a href="#">Appendix 2</a> (page 90)
7d. The overall size of a company's ODI package	<p>We expect companies to develop their ODIs in consultation with their customers, and obtain customer support for the overall range of possible bill impacts from ODIs (referred to as the RoRE range in the PR19 methodology).</p> <p>We expect companies to propose approaches to protecting customers in case their ODI payments turn out to be much higher than their expected range for ODIs.</p>		✓	✓	<a href="#">Final Methodology</a> - Chapter 4 (page 60)

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
7e. ODIs for resilience performance commitments	Companies should only propose financial ODIs related to resilience performance commitments if they reflect the particular resilience challenges facing them, are supported by evidence and by their customers and do not involve ODI outperformance payments that overlap with funding received through the cost allowances.			✓	<a href="#">Final Methodology</a> – Chapter 4 (page 49)
7f. ODIs for asset health performance commitments	<p>Companies should engage with their customers and CCGs on how their asset health metrics protect current and future customers and the environment.</p> <p>Companies should explain to their customers, CCGs and Ofwat the size of their asset health underperformance penalties (and any outperformance payments), and how they relate to their past performance and the asset health challenges they face.</p> <p>Companies can only propose outperformance payments for asset health performance commitments if they can show there are benefits for customers and their proposals reflect evidence of customer preferences.</p>		✓	✓	Final Methodology - <a href="#">Appendix 2</a> (page 27 - box)
7g. Enhanced ODI outperformance payments and underperformance penalties	The enhanced outperformance and underperformance payments are only appropriate for the common performance commitments, which are based on comparable data. This is so that customers, CCGs and Ofwat can be more certain that the enhanced outperformance threshold truly represents frontier-shifting performance.		✓	✓	Final Methodology - <a href="#">Appendix 2</a> (page 84)
<b>8. Securing confidence and assurance</b>	This section repeats CCG's main role: it is also important that CCG reports highlight areas of challenge and disagreement, including how the company has responded to challenges and any areas of outstanding disagreement.	✓	✓	✓	<a href="#">Final Methodology</a> – Chapter 13 (pages 220 and 229)

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
	The Environment Agency, Natural England and Natural Resources Wales have also set out wider expectations for companies, as have the UK and Welsh Governments through their strategic policy statements. We expect companies to take these into account when developing their business plans and outcomes, and to implement them when they are in customers' interests and have customer support.				
8b. Corporate and financial structures	We have introduced a new IAP test to require assurance from company Boards that their business plan will enable customers' trust and confidence through high levels of transparency and engagement with customers on issues such as its corporate and financial structures.			✓	<a href="#">Final Methodology</a> – Chapter 13 (page 217)
<b>9. Resilience planning principles</b>	Principle 3: Customer engagement. Assessments of resilience should be informed by engagement with customers, to help companies understand their customers' expectations on levels of service. This will also help companies understand their customers' appetite for risk and how customer behaviour, in matters such as water efficiency, might influence approaches to resilience.		✓	✓	Final Methodology – <a href="#">Appendix 4</a> (pages 11 and 17)
9b. Operational resilience	The company will need to demonstrate the incremental improvement of the proposed investment, that it considered a range of options, and that the proposed solution delivers outcomes that reflect customers' priorities, identified through customer engagement.			✓	Final Methodology – <a href="#">Appendix 4</a> (pages 6 and 17)
<b>10. Securing cost efficiency - need for investment</b>	In relation to cost adjustment claims: Where appropriate, is there evidence – assured by the customer challenge group (CCG) – that customers support the project?	✓	✓	✓	Final Methodology – <a href="#">Appendix 11</a> (page 14 - Box 2 Evidence to support cost adjustment claims)



Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
	<p>Best option for customers:</p> <ul style="list-style-type: none"> <li>• Does the proposal deliver outcomes that reflect customers' priorities, identified through customer engagement? Is there CCG assurance that the company has engaged with customers on the project and this engagement been taken account of?</li> <li>• Is there persuasive evidence that the proposed solution represents the best value for customers in the long term, including evidence from customer engagement?</li> </ul>				
<b>11. Financeability</b>	We will look for evidence of customer support where companies take steps to address financeability constraints.			✓	<a href="#">Final Methodology</a> - Chapter 11 (page 201)
<b>12. Bill profiles</b>	<p>Companies should take into account customers' views on the profile of bills over time, which will enable companies to understand customers' implicit views on the impact of their PAYG and RCV run-off choices on bills, both in the short and long term.</p> <p>We acknowledge feedback from respondents to the consultation and we do not expect companies to directly ask their customers about their PAYG and RCV run-off rates.</p>			✓	<a href="#">Final Methodology</a> - Chapter 11 (page 192)
<b>13. Accounting for past delivery</b>	When testing how well the company has provided evidence for its proposed reconciliations for the 2015-20 period and how well it has followed the PR14 reconciliation rulebook methodology ....we would expect to see.... evidence of customers' support, and the strength of that support, for its proposed adjustments to the 2020-25 price controls.			✓	<a href="#">Final Methodology</a> - Chapter 12 (page 213)
<b>14. The initial assessment of business plans (IAP)</b>	A high-quality business plan (the bullet points most relevant to the CCG role):			✓	<a href="#">Final Methodology</a> - Chapter 14 (page 239) and <a href="#">Appendix 13</a>

Subject area	Description	CCGs to explicitly comment	CCGs to challenge	Customer evidence needed	Reference
	<ul style="list-style-type: none"> <li>• Is grounded in excellent customer engagement, with a wide range of evidence.</li> <li>• Should include stretching outcomes and performance commitments that reflect what customers want, and their relative priorities, and clear line of sight from these through the plan. It should also include evidence of consideration of customer participation;</li> <li>• Is affordable for all current and future customers, with appropriate assistance provided where needed;</li> <li>• Sets out the company's approach to effectively and efficiently identifying and providing support for customers in circumstances which make them vulnerable.</li> </ul>				<p>Table 2 on pages 13-23 sets out the focus, test questions and potential features of high quality, ambition and innovation (against each test area)</p>