

By email to: PR24@ofwat.gov.uk

PR24 and beyond – Reflecting customer preferences in future price reviews

29 January 2021

Dear Ofwat

PR24 and beyond – Reflecting customer preferences in future price reviews

We welcome the opportunity to contribute to Ofwat's early thinking for shaping PR24. As stated previously, this will be complemented by the CMA's findings (to be delivered by mid-March at the latest), and the wider sector contributions to the future regulatory framework expected through the new Future Ideas Lab. The former is expected to help shape future approaches in areas such as Customer Engagement, expenditure assessment and the overall balance of risk and return whilst the latter should replicate the benefits seen through the Marketplace for Ideas that the sector initiated for PR19.

Our response to the discussion paper captures our reflections on the role of Customer Engagement during the PR19 process, responds directly to Ofwat's discussion paper, and offers reflections following the workshop held on 22 January 2021. Noting the CMA process is on-going, this consultation response is therefore made without prejudice to Anglian's inputs to the CMA. Appendix one to this letter provides brief responses to the specific questions set out in Ofwat's discussion paper.

In our view, one of the main positives of the PR19 process was the sector's step change improvement in customer engagement. Fundamentally, this improvement was driven by an increase in the volume and quality of engagement across a range of channels.

In Anglian's case, our engagement activities evolved from PR14 into an ongoing two-way conversation with our customers and their expectations of our business, a conversation that can inform the price review process but whose main purpose is to ensure that all of our business decisions are taken with the benefit of the insights into customer preferences that it provides.

As a result, our engagement process yielded over half a million interactions through 38 channels in the two years prior to submitting our Plan in 2018. This engagement strategy itself was co-created with customers, driven by their views on the long-term challenges facing the Anglian Region, and shaping Anglian's response to these challenges both through our refreshed 25 year Strategic Direction Statement, and how these were to be addressed through our 5 year Business Plan. Customers were clear they were willing to see bills increase to invest to protect the region from the future challenges of climate



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change, growth, resilience to drought and flood while enhancing the environment.

Reflecting the quality of Customer engagement

At the Initial Assessment of Plans, Ofwat recognised the quality of this engagement and how these customer priorities were reflected in our plan. It remains a great sense of pride that Anglian's efforts, and indeed those of our customers and stakeholders, were reflected in Ofwat's "A-rating" for these activities, one of only two A grades awarded to any parameter of Ofwat's wider IAP assessment.

It remains very unclear how Ofwat has assessed the range of customer engagement tools and methods used by companies in drawing up their plans, nor what weight they have given to these inputs in making decisions through the price review process. Instead, Ofwat appears to have intervened significantly to override the preferences of our customers.

It is deeply regrettable that, notwithstanding the high quality of this engagement, and the clear and accurate reflection of customer priorities within the Business Plan that Anglian submitted, as attested to by the Customer Engagement Forum, its outputs were of negligible influence on Ofwat's decisions in its Draft and Final Determinations. It appears Ofwat placed emphasis solely on variations and differences between companies' quantitative parameters such as willingness-to-pay values or ODI rates. This emphasis persists in the PR24 discussion paper which now seems to see nationwide research as a remedy for variations in some research activities, rather than addressing the need for consistency of methodologies that can address Ofwat's concerns whilst, critically, allowing for companies' plans to be tailored to the different priorities and needs of their customers. For example, what matters to customers in Norfolk will likely be very different to what matters to customers in Cumbria. Company business plans, and regulatory assessments, should reflect this difference.

This presents short term challenges for companies such as Anglian and longer term for the sector. Customers and stakeholders will legitimately question the role companies ask them to play in the regulatory system, if they fail to see how their views have shaped companies' plans and future incentives. Given that, over two consecutive price reviews, their views seem to have had little influence on the regulatory outcomes, there is a risk of disengagement for PR24. This would undermine the desirable goal of putting customers at the heart of the price review process.

Common approaches or common research?

As discussed at the recent workshop, it was not fully clear what is intended by "nationwide research", for example whether this relates to willingness-to-pay or affordability research. Both of these have a role in the broader suite of engagement activities, but the emphasis in the paper suggests a common study could be a "silver bullet" for Ofwat's comparability concerns. Such an approach is likely to both stifle innovation and fail to capture effectively the wide range of priorities and differential drivers of what customers value. We do not believe such research can replace the need for company-specific research. To suggest so would be to dilute the importance of companies' direct relationship with their customers, an outcome that we would assume Ofwat would not want.

From a technical standpoint, any nationwide research will need to be able to accommodate the existing variations in current and future levels of service and the legitimate variations

in costs of delivering these services. For example, whilst leakage is likely to be a common concern for customers, the existing levels of service and costs of further improvement vary significantly. For the Anglian region, it is accepted that our frontier level of performance, driven by customer preference and acute water scarcity will drive a higher value placed on further improvements relative to others. Given the varying levels of service and cost across the industry, one size fits all national research will not deliver meaningful results. We believe that it is the views of customers of individual companies that should be the key driver of company investment prioritisation and outcome delivery incentive calibration.

We agree with a drive towards standardisation of methods to enable better comparisons across companies. We believe there is more benefit in seeking to establish common methodological approaches than pieces of common research. This could be established relatively easily and mitigate unnecessary variation driven by research methods. It would improve the quality of information available to Ofwat and customer challenge groups whilst, critically, seeing companies retain ownership and responsibility for engaging directly with their customers about their specific priorities. Anglian would welcome early discussions on this and believes its experience of PR19 would be a particularly valuable input into the process.

The role of CCGs

It was deeply disappointing and disconcerting to hear at the recent company workshop Ofwat continue to question the independence of CCGs, suggesting their independence diminishes during the Price Review process. We fundamentally disagree with the suggestion at the session that this had in some way been evidenced during the on-going CMA process. The persistence of this accusation is both unjustified and disrespectful to the highly-regarded individuals involved in the CCG process, and likely to severely disincentivise future engagement and participation in the future. This would be a retrograde step, as CCGs play a key role in assuring that engagement processes are rigorous, of high quality, and properly reflect the interests of customers. Our experience of CCGs is that they have rightly held us to account on the scale of our ambition set out in our 25-year Strategic Direction Statement, the quality of our engagement, the technical merit of our societal valuation work and ODI calibration, and that this has properly informed our business plans.

In terms of the question of whether CCGs are equipped to deal with potentially technical aspects of the price review process, our reflection on the Anglian experience at PR19 was that it is a matter for our Customer Engagement Forum to determine independently of the company whether it had the skills required. As a result, during the PR19 process, the CEF expanded its expertise, bringing three new members in to ensure it had the necessary knowledge of economic regulation and valuation studies to be able to fulfil its full challenge function. Clearly this option remains open to CCGs to ensure they have the necessary skills to perform their role.

Scope of customer engagement

The suggestion that customers cannot meaningfully comment on complex technical matters or evaluate between different alternative plans does not accord with our PR19 experience. We think it is vital to do so and it is a matter of ensuring the engagement is

of sufficiently quality and well executed. Whilst we would accept that detailed aspects of WACC and the operation of the CAPM model may not be suitable topics for engagement, there are many technical areas, including the question of RCV run-off, where we were able to develop meaningful engagement materials and useful customer views on the approach we should be taking. We consider it will remain important to engage on decisions on whether to recover the costs of investment from current or future customers for PR24 and beyond. Failure to engage on these sorts of topics is not in customers' interests if left solely to either the company or regulator to decide.

Clarity on Ofwat's interventions

Ofwat's discussion paper sets out its rationale for its ex-post interventions to customers' views in setting Final Determinations. Specifically, Ofwat cite interventions were driven by:

- Comparison to other companies "the full dataset";
- Poor triangulation;
- Poor research quality;
- Unexplained variation between companies; and
- Company proposals were deemed inefficient.

It is unclear to Anglian which of these factors Ofwat used to intervene at PR19 in the investment and outcomes supported by Anglian's customers. Going forward, it is important that that if there are to be circumstances when well-evidenced customer views do not flow through to outcomes, there should be a robust and explicit explanation.

As such, we see value in Ofwat setting out ex-ante requirements which stretch all companies to engage with customers in the best way possible.

There remains a risk that Ofwat undermines companies' customer engagement if, subsequent to the business plan submission, it reaches a different conclusion on costs or any of the wider building blocks that affect bills, and then deems previous research irrelevant. We would welcome the opportunity to explore the development of a framework with Ofwat to deal with this challenge.

Moving forward

We believe Ofwat should take the opportunity to give customer evidence a much greater role in future price review decisions – not least as the sector has delivered a step-change in the quantity and quality of its customer engagement and so the evidence emerging from it is much stronger than in the past. This change has been recognised by Ofwat.

For example, in Scotland, the water regulator has been able to use negotiated settlements between customers and companies. In other sectors, regulators have successfully developed approaches that put more weight on customer evidence and help to triangulate with other evidence in reaching regulatory settlements.

In general, the discussion paper is a missed opportunity to put customers at the heart of future business planning processes. There is a risk that Ofwat focusses on alignment of engagement rather than potential alternative engagement approaches and thus dilutes the importance of customer views, and that companies should flex their plans to

accommodate different priorities for different sets of customers. We would encourage Ofwat to work with the sector to assess more fundamentally the full range of potential engagement options and opportunities, including the approaches being explored in other utility sectors and in Scotland.

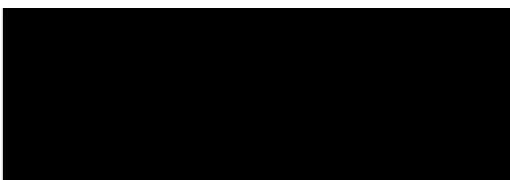
Through the changes to our Articles of Association we have embedded our commitment to operate in the public interest and the need to take decisions that support communities and the environment alongside shareholder interest is therefore a legal duty for all directors of the company. Our core purpose is articulated externally as “to bring environmental and social prosperity to the region we serve through our commitment to Love Every Drop”.

We have been working with customers, employees and other stakeholders to bring this to life in the co-creation of a social contract. This contract will outline the common challenges that we face in our region, a growing population and a changing climate, makes our commitments to developing a sustainable future clear, but most importantly outlines the role that customers can play too. This role is not just in taking direct action in relation to how they interact with the water they use but more importantly the role they play in shaping our planning and decision making. Through activities such as our Customer Advisory Board, our Online Community, our Ambassador programme we already create two-way, business as usual, communications with our customers but we aim to build on these throughout AMP7.

All of these approaches point towards ensuring that companies retain ownership of their engagement activities; act in the long-term interest and maximise the public and societal value delivered.

We look forward to the continued, collaborative discussion to shape the PR24 framework. In the meantime, if there are any specific comments on this response; please do not hesitate to get in touch.

Yours sincerely



Darren Rice
Head of Policy and Regulatory Strategy

Annex 1 - Specific consultation questions

Q1: Do you agree with the goals we have proposed for customer engagement at future price reviews? If not, why not?

Q2: Are there any other goals which you think we should have for customer engagement at future price reviews?

Overall, the goals appear reasonable. We provide targeted comments below.

Enable companies to take responsibility for their relationships with their customers

We agree that Ofwat's framework for customer engagement for PR24 and beyond should be underpinned by the principle that companies are responsible for managing their relationships with their customers and responding to their needs and driving forward plans that deliver for those customers.

The Price Review process should actively support this, setting incentives for high quality engagement and ensure that where there is clear evidence of high-quality engagement this drives improved outcomes through the regulatory process.

Recognise preferences so that price controls are tailored to the specific needs of customers and communities

Yes - it is important to recognise that customer preferences may vary across regions, over different time periods, for a variety of reasons.

Foster collaboration so we learn from each other when working to understand what matters to customers

This goal seems to have a principal purpose to support the use of national research. As set out in this response; we favour collaboration to improve research methods rather than centralised research.

To a certain extent, the development of Strategic Regional Options for water resource investment in AMP8, and the development of regional plans through WRE (for our region) and the other regional groups will drive more collaboration across companies and stakeholders.

We also recognise the natural tension between comparative competition and collaboration given the role of Customer Engagement as part of Ofwat's previously business plan incentives.

Promote transparency so it is clear to all parties how customer evidence is being used in decision making

We welcome the recognition that this has two aspects – for companies to be transparent about their engagement with customers and how the resultant evidence has been used

to inform their plans, and for Ofwat to be transparent about how evidence from engagement has been taken into account in decision making throughout the Price review process.

Our view of the PR19 process is that, beyond the IAP stage of assessment, the quality of companies' customer engagement became somewhat decoupled from the remainder of the PR19 process.

Increase proportionality so that the focus is on producing high-quality engagement instead of lots of it

Our view of customer research and its meaning to our customers does not accord with the view expressed in the CCW study. Nor do we agree with the sentiment that customers cannot be engaged on specific topics.

The challenges of engaging customers on resilience issues are not new. Nor are they unresolvable with high quality engagement. We are concerned that the preference for not engaging customers on these issues is being driven by examples of poor research, rather than positively focussing on how we ensure everyone engages on these issues properly.

Given the long-term challenges facing the sector and the emerging threats of low probability, high impact events, this area is a good example of where collaboration on a common methodology would be beneficial and an area we are willing to contribute.

In terms of overall proportionality; companies, customers, stakeholders and CCGs all face a natural incentive to ratchet down their engagement if they don't think it will be taken into account, as was the case in both PR14 and PR19.

Broaden value so that companies understand people's views as citizens and their views as customers

Through our PR19 customer engagement programme and in the development of our social contract we were able to undertake in depth conversations and debates with customers on complex subjects such as developing adaptation and resilience to a changing climate and the move to the use of more sustainable nature-based solutions.

Through these interactions we saw first-hand the interplay between the roles of citizen and customer. However, it is important to recognise that in our experience the differences between these, on the subjects that we engaged on, was minimal. Through our partnership with the University of East Anglia, the Anglian Centre for Water Studies has considered these matters and is well placed to explore this in more detail with Ofwat if that were helpful.

Q3. Do you agree with the principle that in areas that are of common concern to all customers within a nation, evidence of customers' preferences should be generated in a consistent manner such that results are comparable? If so, why? If not, why not?

Q4. If we make use of collaborative nationwide research in future price reviews:

- Which aspects of business plans do you think should fall within the scope of this research?
- Which organisations do you think should be involved in steering this research?
- When should this research be undertaken?
- How should this research account for differences between England and Wales?

We agree there are potential benefits to a developing a common approach to specific methodological issues to ensure engagement is consistently derived. This is not the same as conducting a single study or national research.

Comparable results, produced using an agreed methodology, would provide greater clarity on where there are differences in customer preferences between regions whilst allowing companies to retain focus on the broad range of specific priorities for their respective customers.

As set out above, we do not support the need for national research in deriving consistent comparable outcomes. The emphasis on this research as set out in the paper risks placing significant weight on a single piece of engagement, which is not reflective of the broad range of engagement companies have with their customers.

Such research could only ever be a complement to companies' specific engagement and insight rather than substitute as it inferred by the paper. Given the need to reflect company specific differences, to make it meaningful early engagement and debate is required.

The research needs to account for differences between England and Wales, but also between regions. Cost and service drivers in Wales and South West England may potentially be more similar for example, but they could vary significantly from the drier regions.

Q5: To what extent do you think it would be necessary for us to provide guidance on customer engagement, assurance and other issues at future price reviews if we made – or did not make – use of collaborative nationwide engagement?

Q6: To the extent that you consider further guidance is necessary, what areas should this cover?

We do not consider that the role of guidance for customer engagement is dependent on the future decision on national research, which as we set out above we see this as a narrow component of the broad engagement and insight activities undertaken by companies.

As Ofwat will be aware, any consideration of guidance needs to be in the context of the incentive properties it presents. For customer engagement, there is a risk that prescription

stifles innovation or encourages companies to favour one form of engagement over another if it is perceived to more closely align with Ofwat's guidance. Any guidance should focus on providing incentives for companies to innovate how they engage with customers, making use of the wider range of evidence and insight to develop their plans. It is clear Ofwat perceives triangulation of evidence as a challenge.

For PR19, we consider that both the CCWater guidance for triangulation and Ofwat's own Aide memoire documents were both very useful and we would welcome working on refreshing these equivalent materials for PR24.

Q7: Are there other models which you think we should consider for providing assurance at future price reviews? If so, what are the benefits of these alternative approaches?

This question in the discussion paper follows from a brief discussion of the benefits of CCGs, their ongoing role given the potential introduction of nationwide research and whether these should evolve into national CCGs¹.

We would note that for many companies, the introduction of CCGs has been one of the key positive features of the last two price reviews, bringing a sharper focus on the voice of the customer and insights which have resulted in more customer-focussed plans and a step change in the quality and depth of engagement.

Given the diverse range of how different issues affect different customer groups (for example risks associated with drought and flood are not uniform across the country, nor is the make-up of companies' customer bases) we are sceptical of the role of a national CCG.

Any future arrangements should ensure that these previous benefits are retained. Some companies would see benefits in CCGs evolving to play a greater role, perhaps along the lines of negotiated settlements, which we note will be considered in the forthcoming PR24 methodology consultation.

We believe this topic is an area which would benefit from further thinking.

Q8: To what extent do you think that the research techniques which have previously been used in the water sector are suitable to enable companies' business plans and our final determinations to reflect customer views? Do you think any particular approaches should be revisited?

Q9: Do you think that there are alternative approaches that we might usefully adopt in water, including those used in other sectors and potentially outside the area of economic regulation? If so, which techniques and why? If not, why not?

PR19 demonstrated there are a wide range of channels that companies used in engaging with their customers.

¹ Pages 34-35 of the paper

We agree that it is appropriate to review the full range of approaches which can be used to elicit customer views and assess the appropriateness of these approaches to the water sector. In that context, we are unclear why the discussion paper² places a disproportionate weight on the future role of stated preference (or willingness-to-pay) methodologies. Both the PR14 and PR19 methodologies encouraged companies not to over-rely on these techniques to determine customer views. We support this; this was reflected in our own plan where we used 38 different channels to engage customers and develop our plans.

Ofwat's paper presents a narrow view of the challenges with stated preference techniques and does not recognise the resources that companies, their consultants and market research partners have invested in mitigating these potential issues. Nor does it mention the innovative techniques that were developed during PR19, including for example for Anglian, the use of alternative wellbeing techniques to derive customer priorities.

In terms of the broader question of alternative engagement frameworks, we think there is merit in further exploration of wider approaches such as those in use by WICS or a form of negotiated settlement or constructive engagement as used by the CAA.

Q10: Are there any areas of the price review where the scope to solicit informed opinions from customers is intrinsically limited?

No. One of the major improvements in customer engagement for PR19 was companies using a range of channels and methods to have deep, more informed conversations about specific topics.

For example, with Anglian's online community we explored customers' view on our proposed 25-year Strategic Direction Statement and our long-term ambitions. As a direct result of this engagement we changed our ambitions; promoting a long-term focus on improving the ecological status of our catchments as one of our four ambitions.

Further, within Anglian's online community we were able to test levels of understanding on a range of issues and actively use this community to develop our engagement materials such that they have been "road tested" before being widely deployed.

Q11: Do you think there are other ideas we should be considering for shaping customer engagement at future price reviews? If so, how would these ideas help deliver on the goals proposed in this paper?

We think that PR24 would benefit from Ofwat specifying clearly how the quality of customer evidence will be linked to regulatory outcomes during the PR24 review.

Ahead of the May 2021 framework paper, we encourage Ofwat to explore more fully alternative customer engagement frameworks and assess how these could enhance companies' emphasis of delivering public value.

² Pages 36-37