



## **CONSULTATION RESPONSE**

# **OFWAT PR24 AND BEYOND: REFLECTING CUSTOMER PREFERENCES IN FUTURE PRICE REVIEWS – A DISCUSSION PAPER**

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### PR24 and beyond – Reflecting customer preferences in future price reviews – a discussion paper

Thank you for the opportunity to share our views regarding Ofwat’s discussion paper on reflecting customer preferences in future price reviews.

At Northumbrian Water our customers are at the heart of everything that we do. It is very important to us that we continue to engage directly with our customers and have deep and meaningful conversations with them, so that we can understand what is important to them.

Continuous and on-going conversations with our customers are central to our unrivalled customer experience strategy, and they always will be. Our conversations are not just about price reviews, they are about how we deliver excellent service to our customers on an on-going basis.

Since PR09 there has been a huge step change in the approach to and quality of customer engagement with customers of water and wastewater companies:

- At PR09 customer engagement was a three-stage process.<sup>1</sup> Stage 1 was company research with input from CCWater; stage 2 was stakeholder research led by CCWater; stage 3 was Ofwat led research with the results provided to companies.
- Customer engagement then evolved substantially at PR14 when Ofwat challenged companies to “take full responsibility for planning their business and listening to their customers, and not simply tick regulatory boxes.”<sup>2</sup>
- For PR19, Ofwat built on the PR14 framework to make “further changes to empower and incentivise companies to address the future challenges that the industry faces”.<sup>3</sup> Ofwat also encouraged companies to “to be much more innovative in their approaches to customer engagement.”<sup>4</sup>

We strongly support this direction of travel. Encouraging companies to own the relationship with their customers, and reflect their preferences in their service offerings and future plans, rightly keeps companies fully accountable for delivering for their customers, and mimics the way that companies would operate in a competitive market place.

At Northumbrian Water, we stepped up to this challenge and developed our customer engagement strategy, alongside continually looking for creative and innovative ways to engage with customers. For PR19, we embarked on a comprehensive, robust and transparent programme of customer engagement. Through gaining a deep and meaningful understanding of our customers’ needs preferences and priorities in relation to the services that we provide, we co-created a plan that 91% of customers deemed to be acceptable.<sup>5</sup>

Overall Ofwat recognised “Northumbrian Water provides high-quality evidence of several approaches to talking and listening to customers”<sup>6</sup> and graded us as B in its initial assessment of business plans.

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<sup>1</sup> Ofwat, Setting price limits for 2010-15: Framework and approach, p15

<sup>2</sup> Ofwat, Setting price controls for 2015-20 – final methodology and expectations for companies’ business plans, p3

<sup>3</sup> Ofwat, Delivering Water 2020: Our final methodology for the 2019 price review, p8

<sup>4</sup> Ofwat, Delivering Water 2020: Our final methodology for the 2019 price review, p22

<sup>5</sup> Living Water – Our plan 2020-25 and beyond, Section 2 Co-creating our plan

<sup>6</sup> Ofwat, PR19 initial assessment of business plans: Summary of test are assessment, p30

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This outcome was supported by our CCG, who recognised that Northumbrian Water “is a company that constantly engages with its customers; and it doesn’t just do it when developing a business plan.”<sup>7</sup> Water Forum members attended 41 research events and in doing so had a clear line of sight from customers’ views to our plan.

We strongly believe that it is fundamentally important to our customers that we continue to directly own our relationship with them. In particular, so that we can continue to engage with our customers at a local level in order that that local preferences can be reflected in the services we provide.

We do acknowledge that in a limited number of instances it was difficult to compare customer engagement results across the industry at PR19, and that in these cases improving consistency would be beneficial to a successful outcome at PR24.

However, we feel that it is of vital importance that this is addressed in a way which does not undermine the direct relationship between companies and customers, especially in relation to understanding their needs, preferences and priorities regarding the services that we provide. Talking directly with our customers demonstrates to them that their opinions matter to us and that we take them seriously.

Our suggestion is that Ofwat achieves this consistency through the provision of clearer guidance and methodologies for customer engagement at PR24, determining what good practice is and allowing companies to innovate beyond good. We also suggest that Ofwat provides guidance to companies on how it intends to use the outputs from companies’ customer engagement, in particular setting out how engagement results will be balanced with other evidence when reaching determinations.

We are concerned that returning to a PR09 type framework with nationwide research would be a step back from the progress made and could stifle innovation.

The evolution in customer engagement approach at PR14 and PR19 facilitated much needed creativity and innovation. This allowed companies to learn from each other and a similar approach at PR24 would facilitate further innovation. Gamification, more creative and immersive exercises, and ethnographic research are all examples of improvements made by some companies at PR19.

Companies already share best practice and learning from each other both within and outside of the water industry. For example, at the MRS Utilities Conference in 2017 we shared our innovative approach to taking customers on a journey to become active participants in the creation of their water services. In 2018, at the annual conference, we shared detail of our innovative service valuation tool.

The world has changed significantly since PR19 and the ongoing ramifications of the Covid-19 pandemic are likely to have significant consequences for the way engagement with customers is conducted at PR24, certainly in the early stages. Ongoing innovation will be vital to ensure that these challenges are overcome in a way that does not compromise the quality of that engagement - it is difficult to see how a centralised approach to engagement will deliver this essential innovation.

In our early thinking for PR24, we are considering whether there is an opportunity to give customers and customer representatives even more control over some aspects of our plans and services i.e., are there aspects which would lend themselves to companies working directly with customers to form a ‘negotiated

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<sup>7</sup> Northumbrian Water and Essex & Suffolk Water - Water Forums Report – A Report to Ofwat regarding NWL’s business plan 2020-2025, p5

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settlement’. Examples could be developer services with developers, or non-household wholesale services with retailers. We would welcome the opportunity to debate this model of engagement more widely.

In the rest of this document, we answer the questions set by Ofwat in its consultation.

#### OFWAT GOALS FOR CUSTOMER ENGAGEMENT IN FUTURE PRICE REVIEWS

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

We strongly support the **Enable companies** goal.

Our customers are at the heart of everything that we do. It is vitally important to us that we own our relationship with our customers. In doing so, we will continue to have a deep and meaningful understanding of their views, preferences and priorities in relation to the services that we provide.

We strongly support the **Recognise preferences** goal.

We are in a fairly unique position of having customers in two very different regions of England. Our customer insights (through research as well as day to day transactions) tell us that customers’ preferences are often very different dependent upon where they live.

These two goals are of the utmost importance to enable companies to reflect customer views in their plans and services, mimicking the way that companies would operate in a competitive market place.

We strongly support the **Promote transparency** goal.

We are openly transparent about how we engage with our customers and how their views shape our plans, both with our Customer Challenge Groups (The Water Forums) and with our regulators. We invite Water Forum members and regulators to witness our customer engagement firsthand.

We present findings of customer engagement to The Water Forums and provide them with a transparent line of sight to how customers’ views shape our plans. In return The Water Forum provide us with constructive and welcome challenge, which often leads to further improvements to the services we provide to our customers. During PR19 The Water Forums made 112 such constructive challenges.<sup>8</sup>

In their report to Ofwat regarding our business plan, The Water Forums state that they “applaud the significant efforts they have made to make sure that we had the access to whatever information, facility or company director, manager or employee that we wanted, so that we could fulfil our role effectively.”<sup>9</sup>

To ensure continued buy in to the process it is important that this transparency is maintained so that customers and customer representatives can see how their involvement has shaped our final plan. It is of equal importance that the same high bar of transparency regarding reflecting customer views is met in any adjustments made to our plans by regulators.

We have limited support for the **Broaden value** goal.

We are supportive of companies adding public value in the communities that they serve, with one of our own business plan themes being ‘Building successful economies in our regions’.<sup>10</sup> However, first and foremost, we value the opinions of our customers and bill payers, and consider that we should only target

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<sup>8</sup> Northumbrian Water and Essex & Suffolk Water – Water Forums Report – A report to Ofwat regarding NWL’s business plan 2020-2025

<sup>9</sup> Northumbrian Water and Essex & Suffolk Water – Water Forums Report – A report to Ofwat regarding NWL’s business plan 2020-2025, p4

<sup>10</sup> Living Water Our plan 2020-25 and beyond, section 3.6

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this goal to the extent that our customers support us in doing so. It is our customers' views, preferences and priorities that we use to shape the services that we provide to them and for which they pay.

In our view **Fostering Collaboration** and **Increasing Proportionality** are possible means of achieving the goals set out above, as opposed to goals in their own rights. If Ofwat focuses on strongly incentivising companies to reflect customer preferences in their plans and service offerings (as they would be in a competitive market), then combined with existing strong incentives for companies to operate efficiently, companies would be sufficiently incentivised to deliver efficient and effective engagement and would be able to both collaborate and increase proportionality to the extent that they consider these things contribute to that outcome.

Further clarity from Ofwat, in advance, on how it plans to use the results of customer insight and what weighting they plan to put on different types of evidence, would help companies focus on those aspects of engagement likely to have most bearing on plans.

Our outcome “We work in partnership with companies and organisations to achieve the goals that are most important to our customers”<sup>11</sup> is about collaboration. By collaborating with others, we are able to share the costs, risks and benefits of addressing the challenges and opportunities faced by our business, and make a difference to our customers' lives. Our approach to innovation, particularly our annual Innovation Festivals, also demonstrates how much we value collaborative working.<sup>12</sup>

All our engagement with our customers is meaningful, whether that be for research purposes or through day-to-day activities. We have an ambitious goal to “Give every single customer the opportunity to have a strong voice and engage with us, with at least 2m customers participating by 2025”.<sup>13</sup> The more customers that we can meaningfully engage with, the deeper our understanding of their collective views, preferences and priorities will be.

We agree that “customers can sometimes struggle to engage with the full range of topics that are important in a business plan”.<sup>14</sup> However, this should not be a barrier to engaging with customers where appropriate. It would be more appropriate to take customers on an educational journey which then allows meaningful engagement to take place, as opposed to not engaging at all.

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

There is nothing in Ofwat's proposed goals about providing feedback to customers. This could be clarified by adding something to the promote transparency goal.

We note that Ofwat has linked each of the six proposed goals to one or more of the ideas for discussion.<sup>15</sup> This gives the impression that each idea for discussion does not help deliver all of the goals, which in turn means that often the goals are in conflict with one another. For example, using nationwide research does not enable companies to own the relationship with their customers.

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<sup>11</sup> Living Water Our plan 2020-25 and beyond, p178-183

<sup>12</sup> Living Water Our plan 2020-25 and beyond, section 3.4

<sup>13</sup> Living Water Our plan 2020-25 and beyond, section 3.1

<sup>14</sup> Ofwat, PR24 and beyond: Reflecting customer preferences in future price reviews, p7

<sup>15</sup> Ofwat, PR24 and beyond: Reflecting customer preferences in future price reviews, p40

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#### IDEA 1: COLLABORATIVE RESEARCH TO INFORM COMMON AREAS OF BUSINESS PLANS, SEPARATELY ADDRESSING ENGLAND AND WALES

**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?**

We agree in principle that there are areas of common concern to all customers within a nation, and there may be a case for improving consistency of these aspects. However, no evidence has been presented to support centralised collaborative engagement as being the best way to achieve this consistency. In particular, we are concerned that centralising engagement would directly undermine the 'Enable Companies' goal - it would also dilute company accountability for delivering effective engagement and reflecting the resulting customer views in their plans.

Evidence shows us that customers value services differently depending upon their locality and cannot, therefore, be valued nationally.<sup>16</sup>

**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 **do not** support nationwide research being carried out for the purpose of price review business planning.

Where companies are writing a company specific plan for their customers, we consider that they should engage directly with those customers, particularly in order to **maximise companies' accountability for delivering effective engagement and reflecting it in their plans, and to enable companies to fully reflect the views of local customers.**

We think that, in a small number of areas where it would be beneficial, more consistency can be adequately achieved by providing more guidance to companies regarding expected methodologies - see Q6

Where plans or policy positions are being developed on a regional or national basis, then naturally it is appropriate for engagement to be conducted regionally or nationally accordingly in order to support this. For example, customer research and engagement for regional Water Resource Management Plans (WRMPs) is in the process of being developed collaboratively for the five regions that have been defined by Defra.

Similarly, the consumer watchdog, CCW, already carries out nationwide research into common areas in order to inform its policy positions and establish an evidence base to support challenge - for example, through its annual Water Matters research. This provides helpful benchmarks and, in our view, should continue.

Likewise, there may be instances where Ofwat wishes to co-ordinate central customer research to inform aspects of the regulatory framework itself, which would apply to all companies. This could include

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<sup>16</sup> For example, Our Plan 2020-25, Appendix 2.2 Compendium of Customer Engagement Summaries, p36, sets out differences in Social Tariff support.

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definition of common performance commitments and setting boundaries for associated penalties and rewards, for example.

**However, for the reasons set out above, all engagement regarding the development of company business plans - operating within that regulatory framework - should sit with companies.**

#### **IDEA 2: CONSIDER WHETHER THERE IS LESS NEED FOR PRESCRIPTIVE GUIDANCE AT FUTURE PRICE REVIEWS**

**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?**

We would like Ofwat to define what they believe to be best practice and what good looks like and in so doing set a minimum standard for quality - in order to avoid the circumstance where outputs of engagement cannot be reflected in plans due to poor quality. Companies should then be allowed to base their customer engagement on that as a minimum and then innovate to continue the journey from good to excellent.

If Ofwat is to provide guidance then it needs to do so as a matter of urgency, as companies have already begun PR24 planning and customer engagement so that it can be aligned with WRMPs and DWMPs.

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

The two main areas where it has proven difficult to compare companies are service valuations (or Willingness to Pay (WTP)) and acceptability testing. We would welcome clearer guidance and/or a methodology on how Ofwat expects these key pieces of customer engagement to be conducted to enable comparability.

An example of where WTP results can vary widely is social tariffs. It is clear when some companies' customers are prepared to cross subsidise five times more than others, there have been differences in research approaches. The postcode lottery that we now find ourselves in with affordability stems from the wide range of approaches that companies have taken to this engagement.

We would also welcome guidance on how Ofwat intends to use the outputs of engagement in its approach to reviewing plans and setting determinations - this would enable companies to focus engagement efforts on those aspects likely to make the most material difference to plans. In turn this would ensure continued buy in from customers and CCGs, as their contribution to the planning process would be visible. It would also contribute to transparency by clarifying how customer views are reflected in determination decisions.

**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?**

We consider that CCGs were an important aspect of assurance at PR19, and that this approach should continue. The NW and ESW Water Forums (our CCGs) provide independent scrutiny, challenge, and assurance on behalf of our customers on company performance and during price reviews. Specifically, at PR19 The Water Forums provided independent challenge and assurance on the quality of our customer engagement and the extent to which the results of that engagement drove decision making and were reflected in our plan.



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Following submission of Our Plan 2020-25, an independent review of The Water Forums was conducted for The Water Forums' Nominations Committee. This included interviews with Water Forums' Chairs and members, representatives from the NWL Executive Leadership Team and Board, and senior managers at NW and ESW.

The outputs from this review were used to strengthen the Water Forums structure including recruitment of a new Chair to a single Water Forum, recruitment of NW and an ESW vice chairs and the establishment of formal working subgroups. These subgroups allow even closer scrutiny of company activities focusing on customer engagement, environment, performance and delivery, and drinking water quality. The subgroups are accountable to The Water Forum.

We are very confident that the new structure of The Water Forum will allow it to provide independent challenge and assurance. We would be happy to share the model for the structure of The Water Forum more widely.

Ofwat would be welcome to attend Water Forum meetings to witness first-hand the constructive challenge and assurance that The Water Forum provides.

The Water Forum are beneficial to our company and our customers, providing constructive challenge and ensuring that customers' views are reflected in the services we provide.

#### IDEA 3: BETTER CAPTURING AND REFLECTING CUSTOMERS' VIEWS IN PRICE REVIEWS

**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 approaches should be revisited?**

We used various techniques to engage with customers at PR19, with Ofwat recognising that "Northumbrian Water provides high-quality evidence of several approaches to talking and listening to customers."<sup>17</sup>

Companies were given the opportunity to be much more creative and innovative in their approaches. Many companies did this, and others will now be able to learn from them. For example, we will be exploring what we can learn from how Anglian Water carried our multi-stage valuation research and how Yorkshire Water combined revealed and stated preference findings together.

Companies already share best practice and learning from each other both within and outside of the water industry. For example, at the MRS Utilities Conference in 2017 we shared our innovative approach to taking customers on a journey to become active participants in the creation of their water services. In 2018, at the annual conference, we shared detail of our innovative service valuation tool. Companies are also working collaboratively to carry our customer research for regional Water Resource Management Plans (WRMP).

As mentioned in our reply to Q6, the two areas where it appears to have been difficult to compare are service valuation and acceptability. Perhaps the industry could work together to develop common methodologies for these important elements of engagement.

**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?**

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<sup>17</sup> Ofwat, PR19 initial assessment of business plans: Summary of test are assessment, p30



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An alternative approach could be to have negotiated settlements. We are considering where in the services we provide to customers this could take place and are thinking about developer services and non-household wholesale services in the first instance. Agreements on levels of service could be negotiated directly with developers and retailers, respectively. We think that initially this should be carried out locally. We would welcome the opportunity to explore this more widely.

Citizens assemblies could be another way to develop future. However, we believe that these would need time to mature.

We are planning to create a ‘horizons board’. This will be a panel of young people who will provide insight, influence how we run our business and jointly plan with us.

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

We acknowledge that there are a few areas of the price review where the scope to solicit informed opinions from customers is difficult.

Our approach to difficult or technical areas where we want customers’ opinions is to seek an informed view. To then educate customers and then seek an informed view.

At the beginning of PR19 we conducted a piece of customer engagement called ‘Defining the Conversation’.<sup>18</sup> Customers clearly told us that there were a few areas where they trusted the company to engage with experts on – we would consider such areas to include items such as the cost of capital and costs efficiency.

#### **FINALLY**

#### **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?**

This consultation has not considered how the Covid-19 pandemic has changed, in some ways potentially forever, approaches to customer research and engagement. Any future methodologies need to consider that.

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<sup>18</sup> Living Water – Our plan 2020-25 and beyond, section 2.1.2