

# 1. Introduction

Working collaboratively with CCW and all companies, we have developed an approach to customer research to inform ODI rates setting at PR24.

Accent and PJM Economics were contracted by Ofwat and CCW to develop a proposal for a methodology for a research approach. Their development approach included academic peer review by Professors Giles Atkinson and Ken Willis. Ofwat, independently, commissioned Professor Stephane Hess to provide further peer review of the proposed approach and later implementation.

We received, unsolicited – on 28 April 2022, a synthesis of peer reviews of a proposal for the ODI rates research methodology. The peer reviews were conducted by four academics/research consultants, brought together by eftec (the ‘**eftec report**’). This study was funded by four companies (Anglian Water, Northumbrian Water, South West Water, Wessex Water) and was shared with us in draft form. It was confirmed on 9 May 2022, at a PR24 collaborative customer research steering group meeting that the eftec report has been shared with all companies. It was written and submitted ahead of Ofwat/CCW/Accent/PJM Economics sharing a review of the initial pilot of the ODI rates research fieldwork and a proposal for a second pilot exercise.

This note sets out themes from the eftec report and Ofwat/CCW’s response to those themes.<sup>1 2</sup>

The eftec report considered:

- the invitation to tender for the development of the ODI rates research methodology, issued in September 2021
- Accent/PJM Economics phase 1 report, issued in January 2022
- An end-January 2022 version of the draft research questionnaire.

During June 2022, we invited each of the four sponsoring companies to meetings with Ofwat to explain our approach to considering the themes raised in the eftec report.

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<sup>1</sup> Eftec report for Anglian Water, Northumbrian Water, South West Water and Wessex Water, [Ofwat ODI research peer review synthesis report](#), April 2022

<sup>2</sup> Documents related to the [PR24 collaborative customer research](#) have been published on our website, including work in progress documents for the ODI rates research.

## 2. The importance of challenge

In accordance with the standards for high-quality research and as part of the governance arrangements for the PR24 collaborative customer research,<sup>3</sup> we are committed to transparent, external and independent challenge of the research approaches developed and how the results of the research are used to inform business plans and our determinations. Accent and PJM Economics, who are jointly delivering the development phase of the ODI rates research project, commissioned peer reviews of the proposed methodology from Professors Giles Atkinson and Ken Willis: their reports were shared with all steering group members at the start of April 2022 and can be found [here](#).

We have also engaged Professor Stephane Hess, a leading international academic expert in choice modelling, to provide peer review of the emerging methodology for the ODI rates research. As at the date of submission of the eftec report, Professor Hess had provided an oral critique of the pros and cons of the proposed methodology for the ODI rates research. His comments were instrumental in the shaping of the methods tested in the second pilot. Since then, Professors Atkinson, Hess and Willis have orally commented on the results of two pilot fieldwork exercises. Expert peer review has been an important part of our quality assurance, ensuring that we have considered all of the potential pitfalls in the options we have considered.

## 3. Peer review themes

The following table sets out key themes from the eftec report, our thoughts on each point, and the final position that we plan to adopt for the ongoing development of the ODI rates research approach.

Our thoughts are created from a synthesis of views from the Ofwat/CCW project team for PR24 collaborative customer research, wider Ofwat colleagues involved in the PR24 price review and customer insight, Professors Atkinson, Hess and Willis, Accent and PJM Economics. The views expressed take account of development of the ODI rates research since the documents reviewed by eftec, including the results of testing of the research approach in two pilot exercises.

We intend to share this document with all members of the PR24 collaborative research steering group(s) and publish it on our [website](#).

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<sup>3</sup> Ofwat, [PR24 and beyond: Customer engagement policy – a position paper](#), February 2022

eftec report theme	Collated thoughts on theme	Ofwat/CCW position for ongoing development of the ODI rates research approach
<p><b>New approach to informing ODIs</b></p> <p>The eftec report argues that an ‘untested’ approach should not be used for something as important as ODIs.</p>	<p>The proposed approach is designed to mitigate issues inherent in Willingness to Pay (WtP) research used widely for PR19 and before. The new method moves away from asking about the value of small changes in risk, which we know is difficult for customers to understand.</p> <p>The development phase included testing of the method and cognition with customers – we undertook two pilots, involving different variants of our proposed method, to ensure that solutions were found to any key methodological issues of concern.</p> <p>Variants of the method have been used before in the water industry and different</p>	<p>We are satisfied that the proposed method has been adequately tested and offers improvements on PR19 research approaches. We acknowledge that there may be a possibility of further improvements for PR29 and beyond.</p>

eftec report theme	Collated thoughts on theme	Ofwat/CCW position for ongoing development of the ODI rates research approach
	elements of the design have been tried and tested in other contexts. <sup>4</sup>	
<p><b>Contextual information and adherence to demand theory</b></p> <p>The eftec report disagrees with Accent/PJM Economics’ assertion that contextual information (such as current performance, or targets, or location-specific issues) is not essential to estimating marginal benefits.</p> <p>The eftec report asserts that Discrete Choice Experiments (DCE), rooted in current service levels that identify the demand curve locations of estimated marginal benefits, are</p>	<p>We consider that extensive detail e.g., about current performance and location-specific information, can make research more challenging for participants<sup>5</sup> – and that the proposed method does not need this information to derive marginal benefits. A key driver of our methodological design has been to make the approach accessible to survey participants, enabling them to state preferences in a meaningful way.</p> <p>The approach does not focus on the demand for service level changes, an approach that has been found wanting, resulting in excessive sensitivity to the service levels</p>	<p>We remain keen to make sure that the ODI rates research is meaningful and accessible to participants and this is a key strength of our chosen methodology.</p> <p>Our approach focusses on whether an individual experiences a service failure or not. There is no need to attempt to estimate a demand curve at an individual customer level.</p>

<sup>4</sup> For example, Accent –PJM Economics research (2017) for Dŵr Cymru utilised an impact-based choice exercise and Accent – PJM research (2018) for Affinity Water utilised a compensation-based exercise.

<sup>5</sup> See, for example, Blue Marble Research (commissioned by CCW), [Engaging water customers for better consumer and business outcomes](#), April 2020.

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<p>dismissed by citing problems that are not well-evidenced.</p>	<p>shown.<sup>6</sup> Our academic peer reviewers agree with our view that DCE designs that incorporate small changes in probabilities are particularly unsuited to this research.</p> <p>It is also not necessary to calculate the unit values that are used in ODI rates and CBA of service level changes. Instead, the proposed approach focuses on obtaining an estimate of the amount of money required to compensate customers to equate the utility of the compensated service failure with the utility of the status quo. This measure is fully consistent with welfare economics.</p> <p>Covariates from the respondents could be used in the models to understand how behaviour in the survey varies as a function of their circumstances/context.</p>	

<sup>6</sup> Metcalfe, P.J. and S. Sen, [Sensitivity to Scope of Water and Wastewater Service Valuations: A Meta-analysis of Water Price Reviews in Great Britain](#), Journal of Environmental Economics and Policy, 11(1), 21-38, August 2021

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<p><b>Use of Willingness to Accept (WtA) in place of WtP</b></p> <p>The eftec report argues that WtA is not appropriate for informing investment decisions.</p> <p>The eftec report argues that WtA may lead to over-inflated ODI rates.</p>	<p>Our peer reviewers, Professors Stephane Hess, Giles Atkinson and Ken Willis agree that a WtA approach can be appropriately used to support setting ODI rates.</p> <p>Accent/PJM Economics’ phase 1 report explains how the values generated could be used as part of CBA, to inform investment decisions. Further, it is important that consistent values inform ODI rates and investment decisions.</p> <p>It is accepted that WtA can generate higher results versus WtP. We will consider this risk during analysis of the research results.</p>	<p>We are satisfied that WtA is an appropriate research method to inform ODI rates.</p>
<p><b>Survey Methodology</b></p> <p>The eftec report is critical of several aspects of the methodology employed to survey water consumers; sample sizes that are too</p>	<p>On the contrary, we see many strengths in the survey methodology employed. We have considered carefully the minimum sample sizes required at company level, balancing this carefully against proportionality.</p>	<p>We have no concerns in this area.</p>

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<p>small, lack of clarity about how to ensure that samples are representative and capture sufficiently the preferences of vulnerable consumers and the postal-to-web component of the fieldwork which is described as 'clunky'.</p>	<p>Further, a significant benefit of the centralised approach is the ability to pool samples across companies enabling comparisons and benchmarking within models. This is particularly so for sub-populations, such as vulnerable customers, where the pooling of sample can provide much more statistical power for analysis than has previously been possible with company level research.</p> <p>We have ensured that at least 50% of each sample stratum is obtained using a random sampling methodology, rather than online panels (which was the preference of most companies). Results will be weighted to Census benchmarks with careful attention given to mode and sample source effects.</p> <p>Companies have been given the opportunity to request booster samples to meet any additional analytical needs they might have.</p>	

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	<p>Postal-to-web fieldwork approaches have been widely used for key national surveys during the Covid-19 pandemic and have proved a highly effective and inclusive method of surveying households. We tested the approach in the first pilot and it worked well, with the response rate of 11.4% exceeding our expectations.</p>	
<p><b>Environmental outcomes</b></p> <p>The eftec report asserts that the proposed method is problematic for valuing environmental outcomes, and questions whether non-use values are included in the design.</p> <p>The eftec report argues that there are many context effects in which being asked to respond as a consumer or a citizen can make a difference to people’s choices.</p>	<p>Non-use value is captured in the design by virtue of the fact that people are encouraged to consider how they feel about the environment when they make their choices. To the extent that they care about it independent of their use of it, this non-use value will be captured in the relative impacts.</p> <p>Accent/PJM Economics explored the issue of consumer versus citizen in its phase 1</p>	<p>We are satisfied that we are using an appropriate conceptual basis for the research.</p>

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	report. They agree with the point made in the eftec report.	
<p><b>Long-term perspective</b></p> <p>The eftec report argues that WtA is not an appropriate method for valuing long-term outcomes.</p>	<p>The ODI rates research project is about setting incentives for the next 5-year price review period.</p> <p>For enhancement proposals and/or incentive rates for bespoke performance commitment proposals, valuations from the ODI rates research are likely to be a reasonable starting point for benefit estimates.</p>	<p>We will use the results of the ODI rates research to inform setting of ODI rates for PR24.</p> <p>Many long-term targets are set by government. Research about long-term outcomes is problematic – a point that equally applies to WtP.</p> <p>We expect companies to refer to the standards for high-quality research as they plan engagement with customers to inform long-term delivery strategies.</p>
<p><b>Timing</b></p>	<p>We have continued to explain the timing of the different stages of the ODI rates research – and are continuing to endeavour to respond to companies’ requests that our</p>	<p>We are expecting to share the main fieldwork exercise dataset in early September, marginal benefits in October and are still aiming to produce indicative</p>

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<p>The eftec report argues that the timing of the ODI rates research is too late for company purposes.</p>	<p>initial view of ODI rates is shared as soon as possible.</p> <p>We will make the research data-set available to companies as soon as available.</p>	<p>ODI rates in December 2022/early 2023 as set out in the <a href="#">draft methodology</a> for PR24 and at a recent <a href="#">PR24 collaborative customer research steering group meeting</a>.</p> <p>The final methodology for PR24 will be published in December 2022, with companies’ business plans and long-term delivery strategies due to be submitted in October 2023.</p>
<p><b>Triangulation</b></p> <p>The eftec report argues that Ofwat should make use of multiple evidence sources to set ODI rates.</p>	<p>We will do this.</p> <p>Our PR24 draft methodology explains that, where credible information exists, we will take account of that information alongside other relevant factors as part of calibrating the final ODI rates during the determinations phase of PR24.</p>	<p>We have signalled that companies should not do research that duplicates the centralised ODI rates research (to protect customers from duplicate costs). But some companies may plan to conduct alternative research to inform their investment planning or incentive rates for bespoke performance commitment proposals. Where this is done, we expect the standards of high-quality research to be met.</p>

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		<p>We agree that triangulation is important. We expect the ODI rates research will provide the key input to setting ODI rates at a company level, but we will take account of different sources of relevant evidence where appropriate to do so.</p>
<p><b>Other approaches to setting ODI rates</b></p> <p>For example, cost of delivering the service, ‘non-economic punitive or reward grounds’, qualitative research, or use past evidence.</p>	<p>We've decided to use a benefits-based approach to setting ODI rates, rather than costs. Shifting to costs would be a departure from PR14 and PR19 and we're not convinced it would deliver better outcomes for customers.</p> <p>Use of qualitative research for setting ODI rates would be a more significant departure from prior methods.</p>	<p>We will continue with our approach to informing ODI rates using benefit valuations.</p>