



Towards Water 2020 - meeting the challenges for water and wastewater services in England and Wales

1. Introduction

- 1.1 The Consumer Council for Water (CCWater) is the statutory consumer organisation representing water and sewerage consumers in England and Wales. CCWater has four regional committees in England and a committee for Wales.
- 1.2 We welcome the opportunity to contribute to Ofwat's development of regulation in the water and wastewater sectors, as part of the Water 2020 project.

2. Executive Summary

- 2.1 We support the integrated approach Ofwat is applying to its forward thinking about its various duties and regulation of the water industry in the coming years. We also agree that the water and wastewater sectors need to not only deliver acceptable and affordable services that meet customers' expectations, but also deepen customers' trust and confidence.
- 2.2 This response raises a number of challenges that we believe Ofwat needs to recognise. Our priorities for Ofwat to consider are summarised below.
- 2.3 Price setting
 - Five year price controls should be set in the context of a long term strategic plan for each water company, to ensure that long term risks such as the effects of climate change and asset resilience are well evidenced and considered in the round;
 - The strong customer input into the 2014 price review should be built upon, with Ofwat showing more clearly how evidence of customers' views has driven price determinations and investment decisions. CCWater can have a role in helping the industry share good practice on customer engagement, challenging where necessary;
 - The outcome approach should be retained to ensure there is a focus on 'the end result' for customers. The range of performance commitments set at the 2014 price review should produce a range of data that can be used to ensure that performance targets for companies at subsequent price reviews are sufficiently challenging, leading to a continual improvement in service standards;
 - Customer Challenge Groups (CCGs) should be retained for future price reviews, though their role and remit needs to be made clear up front. Through PR14 in practice, CCG's acted (to a lesser or greater extent) as groups of stakeholders, with unclear guidance from Ofwat as to the extent to which they should challenge companies. There is a risk that any desire by group members or Chairs to reach a mutual agreement across all stakeholders on company proposals may dilute the group's objective to challenge on customers' behalf. There is an opportunity for PR19 and beyond to provide guidance to focus these groups on their objective of challenging companies on behalf of customers (using robust evidence of customers' views as the basis for this) with CCWater and others having a key role in this process; and
 - Ofwat should explore whether it can provide more comparative information about companies' totex position and the cost of capital earlier in the process so that Customer Challenge Groups (CCGs) can challenge companies. However, this would

need to be done in a way that avoids the risk of companies' gaining an advantage at the expense of customers.

2.4 Market reform

- Once the market opens, the non-household retail market should be assessed to ensure that it meets customers' expectations. We can assist Ofwat in this through our business customer tracking survey; and
- Any consideration of upstream competition in the wholesale chain should be based on a robust assessment by Ofwat of the benefits v risks to customers. Our concern is that the risk to long-term returns may potentially deter or delay investment in resource development. Furthermore, depending on the nature of upstream competition there may be pressure to de-average prices. Neither, we believe, would be in the long-term interests of customers.

2.5 Approach to regulation

- Ofwat should continue to apply a risk based approach to regulation, focusing more on comparatively poorer performing monopoly companies, giving an added incentive to companies as better performers would receive 'lighter' regulation;
- While financial incentives can drive service improvements, Ofwat should be mindful of the risk of a negative customer reaction if incentive rewards are seen to drive bill increases in the future; and
- Ofwat should address the imbalance of risks and rewards between companies and their customers. We consider that the index linking of Regulated Capital Values and wholesale prices, coupled with what we believe to be an over estimation of risk in the cost of capital (as reflected in the equity beta), means that companies and their investors are over protected from risks to the detriment of customers. While customers may eventually obtain a share of cost efficiencies, more could be done to ensure customers no longer over compensate companies for a level of risk in the cost of capital that is not fully reflective of market evidence.

2.6 Our response to Ofwat's key questions and our comments on the suite of discussion papers provide more detail. We look forward to Ofwat engaging with CCWater and the rest of the industry in more depth on these issues in the coming months.

3. Response to Ofwat’s key questions

3.1 Ofwat’s suite of discussion papers outline six high level key questions on Ofwat’s future regulation of the water and wastewater sectors. Some or all of these six questions are raised in each discussion paper. Below we answer the key questions in the context of the ‘themes’ of each of the four discussion papers.

KQ1: How do we regulate to encourage service providers focus on their customers over the longer term, rather than focusing their effort around periodic reviews?

- Regulation of the monopoly water and wastewater sectors should contribute towards household customers (who will not have a choice of supplier) having greater confidence in the sectors and higher customer satisfaction with both service and particularly value for money. CCWater tracks customer satisfaction for all of the incumbent water companies in its annual ‘Water Matters’ tracking research¹. This should be used as a measure of customer opinion to show how well the sectors (and by implication, the regulation of the sectors) is delivering for customers.
- Companies should produce five year business plans that are considered in the context of a longer term strategic plan that addresses future challenges such as asset resilience and the effects of climate change on delivering the service customers’ expect. Both the five year and long term plans should identify short and long term outcomes that are defined by evidence of customers’ views taken from customer research, complaints and engagement. The long term plans should show how investment can be paced to provide bills that will remain within an ‘envelope’ of long term customer acceptability. Both plans should also be subject to scrutiny and challenge by CCWater and Customer Challenge Groups (CCGs).
- In terms of market reform in the non-household retail sector, customers’ ability to switch retailer should act as an incentive for retailers to understand their customers’ expectations and meet or exceed them in order to retain their custom. However, low level regulation of the retail market will be needed for some time after market opening until evidence shows that the market is operating in a way that offers customers’ tangible choice.
- The possible introduction of wholesale upstream competition needs to be considered in the context of the potential benefits or risks to customers. Our concern is that the risk to long-term returns may potentially deter or delay investment in resource development. Furthermore, depending on the nature of upstream competition there may be pressure to de-average prices. Neither, we believe, would be in the long-term interests of customers. Impact assessments will be needed to evaluate this.

KQ2: How do we build on the customer-focussed approach to the 2014 price review (PR14) and promote and maintain genuine customer engagement that drives companies’ businesses?

- The extensive customer engagement and research conducted by companies through the 2014 price review is a starting point for companies to build a culture of involving customers in decisions that affect them. The focus on customer priorities is positive and should encourage customer engagement to take place in terms that are meaningful to them, and in a way that helps drive company strategy.

¹ Water Matters - CCWater’s research on household customers’ views of their water and sewerage services [here](#).

- While companies should continue to ‘own’ their engagement with customers (i.e. a non-prescriptive approach from Ofwat), innovation in customer engagement and research should be encouraged by sharing good practice and learning from similar customer engagement used in other sectors.
- CCGs should continue to be a platform for scrutiny, challenge of company proposals, and monitoring of performance. However, it is important that CCGs demonstrate independence and strong governance, and are provided with the guidance and ‘tools’ (such as comparative data) to enable them to challenge effectively.
- Our qualitative research² shows that in terms of customer involvement, customers would expect the following:
 - Customers to have a direct say on their water company’s proposals.
 - CCWater having an active role on CCGs as the ‘customer expert’.
 - The Chairs of CCGs to be impartial and independent - qualities which customers believe could be undermined if the role is funded directly by a water company. Customers liked the idea of a levy or ‘pooled funding’ from across the industry to fund CCG Chairs to mitigate the risk of paid Chairs being “in the pocket” of a water company.
 - CCG membership to be refreshed on a regular basis so the groups hear new voices and avoid becoming stagnated.
 - CCGs to act transparently, including publishing the minutes of meetings.
 - The use of independent customer research as the best way to gather a broad and representative understanding of customers’ views.
 - Companies making efforts to consult customers on issues that affect them, as a way of showing a company’s genuine intention to listen to customers.

KQ3: How do we regulate to encourage service providers to discover new ways of delivering outcomes to customers, which reduce cost and improve service?

- CCWater has previously supported Ofwat’s risk based approach to regulation as this means regulation can focus on relatively poorer performing companies, with the incentive of receiving lighter regulation driving companies to perform well.
- Innovative approaches to delivering solutions should be encouraged by sharing good practice. The ‘totex’ approach to evaluating costs should be maintained to reduce bias towards capex based solutions.
- Ofwat needs to continue benchmarking companies’ costs to inform its cost baselines. This can challenge companies to be cost efficient. Challenging performance commitments may also help drive companies to deliver outcomes in an efficient way, taking up innovative new practices where possible.
- CCWater feels that the Service Incentive Mechanism (SIM) has, in concert with our promotion of a ‘right first time’ ethos helped to drive correct company behavior. However, CCWater has raised concerns with Ofwat and companies with regards to the consistency of company reporting. Companies have, on occasion, been reluctant to communicate with customers because it may attract negative customer feedback (and

² ‘Tide of Opinion’ customer research (Blue Marble for CCWater, August 2015) [here](#).

therefore unwanted SIM points). To encourage further improvements in customer service, we would like SIM to evolve further with³

- a reduced quantitative element. These should be based on complaints to CCWater to ensure consistency;
 - the SIM penalty and incentive to be used for both retail and wholesale to ensure each element works well and there are no gaps in customer service;
 - the SIM survey to ensure equality between measures of customers with complaints and enquiries; and
 - a stronger SIM penalty (of up to -3% and incentive of +1%) to sufficiently incentivise the better performers and punish the poor performers.
- We believe a greater focus on customer satisfaction with services and especially value for money with additional incentives / penalties would press companies to innovate for customers and better understand customer segmentation. This will also encourage companies to communicate well and respond to their customers locally on a continuing basis.
 - This would eliminate most inconsistencies and encourage companies to communicate more with consumers. Additionally, this could also encourage companies to develop more innovative customer information (such as showing water use more graphically on bills or developing mobile phone apps that allow easier communication). CCWater has a role in highlighting good practice, and we work with companies to encourage the adoption of social media. However, because these innovations can generate unwanted contacts, companies are dis-incentivised to introduce them.

KQ4: How do we encourage service providers to discover and reveal the efficient cost of providing services?

- Customers will expect companies to deliver services efficiently and provide value for money. The introduction of separate retail and wholesale price controls at the 2014 price review has led to more detailed cost allocations by companies to different parts of the value chain. This clearer cost information, coupled with the financial and operational performance information Ofwat will gather over 2015-20, should help Ofwat develop improved benchmarking tools to identify baseline and frontier efficiencies. These tools can be used to challenge cost proposals at future price reviews.
- In terms of upstream competition, sub-price controls may be needed within the wholesale price control to facilitate new markets (for example, a sub-price control for water resources). To enable this, more detailed cost allocations for parts of the wholesale value chain would be needed, which may reveal further cost efficiencies that Ofwat can benchmark in order to deliver sub-price controls based on efficient costs.

KQ5: How can we best align the interests of investors, management and customers?

- Customers, investors and management would all benefit from a stable sector, where companies are delivering required outcomes as part of a long term strategy. This will help maintain investor and management confidence as long term risks are more clearly identified and addressed. Customer confidence could increase if it is shown that

³ See CCWater's response to Ofwat's consultation on 'SIM 2015 and beyond' [here](#).

outcomes being delivered reflect customers' expectations. Measures such as testing business plans for customer acceptability, and tracking customer satisfaction with value for money, can be used to show how well this is being achieved.

KQ6: How can we maintain investor and customer confidence through the transition to new arrangements?

- Communication with investors and customers needs to clearly explain what is changing, why, and the benefit(s) that will be delivered. An appropriate pace of change will be important in this process to help avoid sudden 'shocks' that may destabilise confidence. CCWater's tracking of customer satisfaction with service and value for money can provide a measure of how well this is being achieved.

4 Further comments

- 4.1 In the appendices to this paper, we detail specific challenges relating to the 'themes' of each discussion paper, alongside a more detailed CCWater view of how Ofwat should deal with these issues, and how CCWater can also have a role in addressing these issues.

Enquiries

Enquiries about this consultation response and requests for further information should be addressed to:

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Discussion paper 1: Meeting the challenges

Challenge faced by the water/wastewater sectors	View on how these issues could be addressed
<u>Environmental pressures</u>	
Risk of increasing water scarcity.	<p>Increasing the trading of water between wholesalers, particularly in areas at risk of water scarcity, could help secure supplies for customers in the long term⁴.</p> <p>However, care needs to be taken with the introduction of upstream reform, and the uncertainties this may bring. A risk to long-term returns may defer or deter investment in resource development. Furthermore, depending on the nature of upstream competition there may be pressure to de-average prices. Neither, we believe, would be in the long-term interests of customers.</p> <p>At future price reviews, we would like companies to be challenged to have more demanding performance commitments on achieving a long term supply/demand balance and lower per capita consumption, in areas where evidence shows customers view these issues as a higher priority and/or where resources are deemed to be scarce.</p>
Improving water quality in rivers, bathing water etc.	<p>We support the catchment management approach. This can be a more sustainable way to manage the water environment as well as being an effective way of encouraging non-water industry sectors to tackle the pollution they caused. Ofwat, working with the EA, Natural Resources Wales and Natural England, could encourage this through providing the industry with a platform to share good practice.</p> <p>The continued use of the totex approach may encourage innovation by helping reduce bias towards capex based solutions, encouraging consideration of all possible solutions.</p> <p>Pacing of improvements needs to be made in a way that keeps customer bills within a level that customers will find acceptable in the future.</p>
Pressures on environmental standards due to climate change and population growth.	<p>We believe that investment in the statutory environment programme should be paced appropriately, to ensure required improvements are deliverable without ‘cost shocks’ that could lead to sharp bill increases for customers.</p> <p>In addition, we would like to see the water industry, its regulators and stakeholders, share good practice to encourage innovative ways of tackling environmental pressures. As</p>

⁴ For more detail, see the section on water trading in our response to Ofwat’s report on ‘Valuing Every Drop’ (2012) [here](#).

	suggested above, Ofwat (in collaboration with the environmental regulators) could provide the industry with a platform for this.
<u>Resilience</u>	
Managing asset performance in the context of climate change.	Investment in asset management needs to be in a long term context. Risks to asset performance could be addressed effectively through the price review process by ensuring that short term investment is delivered as part of a long term plan, with appropriate performance commitment targets and incentives to help drive their delivery. The continued use of the totex approach to costs, and sharing of good practice across industry, could help encourage innovation.
How the introduction of retail and upstream competition may affect resilience.	<p>We would welcome an evaluation of how well the new retail market contributes to the overall resilience of the sector. Such an evaluation will also be needed if upstream competition is introduced in the future (see comments above).</p> <p>We would also wish to ensure that the opening up of competition was not discouraging companies from working together on joint initiatives where these have real potential benefits for customers, the economy and the environment. Regional water resources planning and tariff development being two such activities.</p>
Financial resilience of the sector, in context of possible wider economic changes.	We are concerned about the level of gearing in a number of companies' financial structures and the risks this may have for customers. Therefore we support Ofwat's monitoring of company financial structures and performance, and the use of stress tests to assess the level of vulnerability ⁵ . Ofwat needs to explain its options for intervention if risks/issues in company financial structures or performance are found.
<u>Customer bills and affordability</u>	
Increasing customer satisfaction with service and value for money, and meeting rising customer expectations.	At PR19, we would welcome Ofwat requiring companies to set performance commitments relating to measures of customer satisfaction, particularly satisfaction with value for money which our research shows is a key overall measure of the customer view. This would incentivise companies to further improve their offering to customers. I would also complement the SIM and demonstrate to customers where their money is being spent.
Helping customers with affordability problems in the context of evidence of financial deprivation	The development of social tariffs and other assistance schemes should continue, built on evidence from customer engagement, with CCWater continuing to work closely with companies on this.

⁵ For more detail, see CCWater's response to Ofwat's consultation on its proposed financial monitoring framework (2015) [here](#).

	We would welcome Ofwat taking action if a company has a comparatively poor performance in assisting customers with affordability issues. This could be through the performance commitments mechanism.
Dealing with bad debt	Ofwat could consider incentivising better debt management through reducing allowances in retail controls awarded for bad debt costs.
Upward pressure on customers' bills.	<p>The pressure on customers' bills from investment requirements must be constrained within what customers find acceptable through sensible pacing of improvements, especially lower customer priorities. The sharing and incentivising of more innovative practices may lead to the take up of lower cost and more sustainable solutions to deliver required outcomes.</p> <p>It is important that company business plans and price determinations reflect customer evidence and are tested for customer acceptability. Improvements need to be delivered at a pace and cost customers accept.</p>
Future mergers and acquisitions.	It is important that the merger and acquisition processes identify actions to safeguard customers from the risk of service deterioration, and introduces remedies where applicable to mitigate against the loss of a comparator. Customers should also receive a fair share of the efficiency benefits of a merger or acquisition when such savings are made. ⁶

⁶ For more detail see our response to Ofwat's consultation on Ofwat's approach to future mergers (2015) [here](#).

Discussion paper 2: Policy issues - customer engagement and outcomes

Challenge faced by the water/wastewater sectors	View on how these issues could be addressed
<u>Using customer engagement evidence to drive company service delivery and price</u>	
Making sure companies focus on the long term, not just price control periods.	We would like to see the use of Strategic Direction Statements/Plans as context for five year price controls. In PR09 and PR14, Final Determinations did not clearly show how five year decisions fit in a long term strategy. CCGs and customer engagement have a role in helping companies develop these long term plans.
Engaging with household and non-household customers post 2017	<p>Ensuring non-household customers continue to have a voice in the decisions made at the wholesale level will be a key marker of a successful price review.</p> <p>Getting the avenue for that voice firmly established is important - either allowing the wholesaler to discuss long-term investment decisions direct with consumers or through the retailer.</p> <p>The existence of the non-household retail market should mean retailers are incentivised to engage with customers to understand their views or risk them switching.</p>
The use of 'willingness to pay' (WTP) research at price reviews.	<p>Evidence from customer engagement and research should be the main 'building block' for company business plans and a driver of regulatory decisions.</p> <p>PR14 saw companies using a wide range of techniques to measure customers' service preferences through WTP research. The post-PR14 period is an opportunity for the industry to share good practice and innovation to improve WTP research at the next price review and beyond⁷. CCWater is working with Water UK to provide the industry with a platform to do this. UK Water Industry Research (UKWIR) has already examined effective customer engagement techniques in other sectors that the water industry can learn from.</p> <p>WTP research should not be used as evidence to justify potential customer bill impacts from ODI proposals as it is not a literal measure of the amount of money customers would be willing to pay for specific service improvements. Rather, it produces numerical outputs which feed into cost v benefit modelling.</p> <p>Customer acceptability research is also important to ensure plans will be viewed as reasonable by customers.</p>

⁷ For more detail see section 4.3 in CCWater's assessment of the 2014 price review, 'A Step in the Right Direction' (2015) [here](#).

<p>Diversity of customer research vs. ‘one size fits all’ approach</p>	<p>A ‘one size fits all’ approach to research is prescriptive and may damage the ‘culture’ of companies ‘owning’ their plans and their relationship with customers.</p> <p>We accept that without a prescriptive approach there will continue to be diversity in research methods, but CCWater can provide some consistency and comparability in acceptability testing of business plans, Ofwat determinations and other areas where comparability is desirable.</p>
<p>Understanding the segmentation of customers and responding to customers’ diverse views.</p>	<p>Different groups of customers may have different expectations of service and/or priorities they consider water companies should be addressing. As customer engagement in the sector evolves, greater understanding of customer segmentation may emerge. A key challenge for companies and Ofwat is to ensure that business planning and regulatory decision making takes into account the potentially diverse views and expectations of different customer groups. Companies should be incentivised to understand the diversity of customers’ views by measuring customer satisfaction with value for money annually and testing company proposals for acceptability with different customer groups.</p>
<p><u>The Role of Customer Challenge Groups (CCGs)⁸</u></p>	
<p>CCGs as a form of customer engagement <u>or</u> CCGs having an assurance role.</p>	<p>CCGs operate best when they challenge and assure based on evidence of customers’ views gained through customer engagement and research, and using CCG members’ customer, regulatory or business experience. It would blur the clarity of the role if the CCG were used as a customer engagement vehicle - especially if the variety of participants remained similar to PR14 - regulators, business interests, local authorities and customer groups.</p> <p>CCGs should be used at future price reviews by the companies for their assurance processes, but the CCGs will need to demonstrate their independence from the company. Strong governance arrangements will help reflect this, and providing proof of challenge will help evidence this.</p> <p>Our qualitative research⁹ shows that in terms of customer involvement, customers would expect the following:</p> <ul style="list-style-type: none"> • Customers to have a direct say on their water company’s proposals. • CCWater having an active role on CCGs as the ‘customer expert’. • The Chairs of CCGs to be impartial and independent - qualities which customers believe could be undermined if the role is funded directly by a water company. Customers liked the idea of a levy or ‘pooled funding’ from across the industry to fund

⁸ Our recommendations in this section reflect issues with the role of CCGs raised in section 4.1 of our assessment of the 2014 price review, ‘A Step in the Right Direction’ (2015) [here](#).

⁹ ‘Tide of Opinion’ customer research (Blue Marble for CCWater, August 2015) [here](#).

	<p>CCG Chairs to mitigate the risk of paid Chairs being “in the pocket” of a water company.</p> <ul style="list-style-type: none"> • CCG membership to be refreshed on a regular basis so the groups hear new voices and avoid becoming stagnated. • CCGs to act transparently, including publishing the minutes of meetings. • The use of independent customer research as the best way to gather a broad and representative understanding of customers’ views. • Companies making efforts to consult customers on issues that affect them, as a way of showing a company’s genuine intention to listen to customers.
<p>CCGs scrutiny and challenges on companies’ proposed costs and how Ofwat can assist (particularly where company cost proposals are comparatively inefficient).</p>	<p>Some CCG members may not use the relevant Ofwat documents on cost efficiency comparisons, meaning they often rely on a summary from the company, which may be biased towards the company’s view of the data. While CCWater can take the lead on these challenges within CCGs, an overview document specifically for CCG members from Ofwat to accompany its key publications would help counter this tendency. It should be company specific when relevant.</p> <p>If Ofwat finds that a company is significantly out of line with comparable companies, there should be dialogue between Ofwat and CCG members to show what the problems are, how Ofwat reached its view, and provide advice on the level of efficient costs that the CCG should expect to see for that particular project.</p>
<p>Collaboration between CCGs and the role of the Ofwat Customer Advisory Panel (CAP).</p>	<p>Ofwat’s CCG Chair workshops were valued by the Chairs - but there is a need for more opportunities to meet and share experiences, including companies’ approaches.</p> <p>CCWater is willing to co-ordinate a CCG Chair Forum to enable this. This could include sub-groups of CCG Chairs from specific regions to allow discussion about regional issues (e.g. water resources in the south east of England).</p> <p>It is not clear that there needs to be a role for the Ofwat CAP to have a relationship with the CCGs, as this could risk overlapping with roles that CCWater could deliver, as a co-ordinator of information and sharing of best practice through developing a CCG Chair forum and network.</p> <p>However, to create linkage with the CAP, the CCWater CAP representative could create a two-way feedback process from CAP to the CCG Forum and vice versa. This will be in addition to the CCWater representative giving the CAP insight from CCWater’s CCG members.</p>
<p>Safeguarding the independence of CCGs</p>	<p>The need for CCG Chairs to be independent of the water companies was a recurring theme throughout PR14. The degree to which this has been achieved is subject to debate.</p>

	<p>Our 2014 research¹⁰ with CCG members and companies found there was a general concern amongst members that the chairpersons were not as independent from the water companies as they might have been. Companies argued that they were independent and evidenced this by providing examples of ‘uncomfortable’ challenges.</p> <p>In 2015, we qualitatively researched¹¹ customers about how they viewed CCGs, the role of the Chairman, and issues around independence.</p> <p>The key points from customers about independence were:</p> <ul style="list-style-type: none"> ○ Respondents expected the Chairs of CCGs to be impartial and independent - qualities which they believe could be undermined if the role is funded directly by a water company. ○ If companies appoint a ‘neutral facilitator’ as Chair, then, when prompted, customers liked the idea of a levy or ‘pooled funding’ from across the industry <i>“as a good way to mitigate the risk of paid Chairs being “in the pocket” of the water company”</i>.
<p>Appointment and remuneration of CCG chairs and members.</p>	<p>Our research found that customers expected there to be formal recruitment and selection policies. Using open competition, and a recruitment process using a panel containing persons independent from the company, such as CCWater, could help gain customers’ trust around the process.</p> <p>However, our research showed that direct payment of chairs by companies undermines independence in customers’ eyes.</p> <p>We are working with some companies to develop a way to recruit Chairs and fund their salaries that will meet with customers’ expectations. This means the Chair will not be paid directly by the water company, and there is strong governance around the arrangement to reduce the risk of capture.</p> <p>We are exploring the use of trust funds with independent (of the company) trustees to administer payment, along with a panel that both recruits and if necessary sanctions Chairs who are not appropriately challenging the company or appear captured.</p>
<p>Comparative information made available to assist CCGs challenges</p>	<p>In addition to information on customer engagement plans, options explored for key schemes and maintenance approaches, CCGs should have access to:</p> <ul style="list-style-type: none"> ○ Information on how their local company’s costs compare to other companies for similar work. ○ External consultants reports on schemes costs.

¹⁰ CCWater Research: Customer Challenge Group process - Review of lessons learned (see paragraph 1.2). Link [here](#).

¹¹ CCWater research - A Tide of Opinion - 2015 - link [here](#)

	<ul style="list-style-type: none"> ○ How a local company’s past performance compares to others, or whether there are any trends in company performance in any areas. <p>We recognise that there is limited comparability across industry on PR14 performance commitments and ODIs. However, CCWater will be able to provide comparative information on a range of customer service and operational measures.</p>
<p>Membership profile and rotation of CCG members.</p>	<p>Our ‘Tide of Opinion’ customer research has allowed some customer insight into this issue:</p> <p>Customers and community representatives wanted to see a broad membership on committees or groups that can represent customers, with participation expected from both industry experts¹² and consumer champions.</p> <p>While there was a strong desire for the committee or group to be focused primarily on the views of the ‘ordinary customers’, customers were aware that they did not have the knowledge and understanding of the water industry necessary to make decisions¹³.</p> <p>Respondents thought that experts should play a role in providing information and guidance to ensure the recommendations made by a customer group are realistic and sensible.</p> <p>Customers also felt CCG membership should be refreshed on a regular basis to ensure a balance between experience and knowledge but to prevent against stagnation of ideas and ways of working.</p>
<p>Guidance provided to CCGs</p>	<p>Customer Challenge Groups (CCGs) should be retained for future price reviews, though their role and remit needs to be made clear up front. Through PR14 in practice, CCG’s acted (to a greater or lesser extent) as groups of stakeholders, with unclear guidance from Ofwat as to the extent to which they should challenge companies.</p> <p>There is a risk that any desire by group members or Chairs to reach a mutual stakeholder agreement on company proposals may dilute the group’s objective to challenge on customers’ behalf. There is an opportunity for PR19 and beyond to provide guidance to focus these groups on their objective of challenging companies on behalf of customers (using robust evidence of customers’ views as the basis for this) with CCWater and others having a key role in this process</p>

¹² These were described as specialists who did not work for the water company but who had professional knowledge linked to the water industry e.g. DWI, EA, local government, NHS, academics, scientists, and engineers.

¹³ This theme was also echoed in our 2014 research with CCG members, where those who did not have the relevant expertise found interpreting technical information challenging. Some members felt they did not have the technical knowledge to contribute to discussions and provide informed challenges.

	<p>Such guidance should have particular emphasis on</p> <ul style="list-style-type: none"> • the Groups’ role as a forum for stakeholders to challenge companies on customers’ behalf (but not act as source of customer evidence themselves); • guidance on the suitable balance of stakeholders in the CCG membership; and. • the Groups’ role in challenging any aspect of the company business they believe could be detrimental to customers. <p>This could allow local differentiation and a greater challenge on issues such as costs and cost of capital.</p> <p>This should not duplicate Ofwat’s role on costs and cost of capital - but could increase the scrutiny and challenge of the company. This would help address the findings of our 2014 research with CCG members¹⁴ where the lack of guidance from Ofwat left the CCGs feeling unsure of their remit and scope of work.</p> <p>The CCGs would also find it useful to know how Ofwat plans to use their reports, and to what degree Ofwat’s decisions or challenges will be based on the information within the reports. This could allow CCG reports to carry sections that will aid Ofwat in its work, such as a requirement for challenge logs that could help Ofwat confirm where in-depth analysis is required.</p> <p>The timing of key activity and reports should be clear upfront and remain fixed. This will help ensure members are available at key decision points.</p> <p>CCGs may benefit from additional guidance on the importance of maintaining independence of thought, and what the CCG can do to demonstrate that this is achieved.</p> <p>Our research with CCG members in 2014¹⁵ found that group members had very different starting points in terms of their water industry knowledge. Care had to be taken to bring everyone up to a similar level of understanding during the early stages of the process, which was quite challenging for some groups to achieve. It may be worthwhile for Ofwat and CCWater to jointly produce guidance or run ‘water industry and the price review’ induction sessions for new members. CCWater ran an introduction to the price review session for Citizens Advice Bureau members early in the PR14 process, which was well received.</p>
<p>Empowering CCGs to effectively challenge.</p>	<p>CCGs would be better placed to challenge companies if provided with comparative data by Ofwat on:</p> <ul style="list-style-type: none"> ○ Companies’ cost efficiency; ○ Proposed wholesale and retail costs compared to Ofwat’s ‘baseline’ costs; ○ Capital maintenance; and

¹⁴ CCWater Research: Customer Challenge Group process - Review of lessons learned - Link [here](#)

¹⁵ As 11 above

	<ul style="list-style-type: none"> ○ Possibly the cost of capital. <p>CCWater is able to provide CCGs with comparative information on some aspects of operational and customer service performance from our reports such as ‘Delving into Water’¹⁶, and customer views on the service they receive from water and sewerage companies in our ‘Water Matters’ reports¹⁷.</p> <p>The EA and DWI should also be able to provide comparative data on issues of interest to the CCGs.</p> <p>However, it is crucial to customers that the provision of data is used to challenge companies and not reveal data to companies that could be used to influence their plans at the expense of customers.</p>
Ofwat’s communication with CCGs	<p>The Ofwat workshops were useful, but should be widened to include CCG members, and CCWater.</p> <p>Information was not always disseminated by CCG Chairs, and different messages were heard by different audiences. This has the potential to create tension and discord within CCGs.</p>
Outcomes & ODIs	
Balance between bespoke and comparable performance commitments and ODIs	<p>There was limited comparability on ODIs at PR14 with only 6 common performance commitments (PCs). While PCs and ODIs reflect local company issues and customer views, there are benefits in introducing more comparable measures as this will allow more effective challenges to companies to help drive service improvements and improve comparative performance.</p>
Financial ODIs- developing them further so they influence company behaviour	<p>We understand the regulatory rationale for making ODIs stronger to improve service. But there is evidence that customers do not support the model and potential bill impacts from rewards for ‘doing the day job’.^{18,19} Ofwat needs to be mindful of the risk of a negative reaction from customers if considering increasing the scope for rewards.</p> <p>In our response to the ‘challenges’ discussion paper above, we suggest applying ODIs with strong financial penalties to measures of customer satisfaction. This could mitigate the risk of a customer reaction towards ODI rewards for other areas of service because whilst earning rewards for delivering performance targets, companies will also need to increase customer satisfaction. To do this, as well as demonstrating good service quality to customers, companies would also need to demonstrate that they are delivering value for money.</p>

¹⁶ CCWater Research - Delving into Water - link [here](#) - Performance of the water companies in England and Wales 2010-11 to 2013-14

¹⁷ CCWater Research - Water Matters - link [here](#) - Household Customers’ Views on their Water and Sewerage Services 2014

¹⁸ For more detail see section 4.2 of our assessment of the 2014 price review, ‘A Step in the Right Direction’ (2015) [here](#).

¹⁹ Please see SPA’s customer research for CCWater on Outcome Delivery Incentives (2014) [here](#).

Discussion paper 3: Policy issues - promoting markets

Challenge faced by the water/wastewater sectors	View on how these issues could be addressed
<u>Retail</u>	
Regulating non-household retail prices from 2017.	<p>It will be important for the development of the retail market to assess how well the market is meeting customers' expectations (both before and after market opening). CCWater can have a role in engaging with non-household customers as part of such an assessment. Regulation of the retail market will need to continue until the market has matured and evidence shows an active retail market is meeting customers' expectations and delivering customer satisfaction.</p> <p>When Ofwat set retail default tariffs for non-household customers in England, it needs to ensure there are no sudden changes for customers (especially before they can switch). Any change of tariff that has a detrimental effect on some customers must be phased in with good customer communication.</p>
Regulating the non-household sector in Wales in the absence of wider retail competition.	<p>Without (retail) competition Ofwat should continue to regulate non-household retail prices and service in Wales, including the use of data on performance from the non-household retail market in England as the basis of this. Non-household customers in Wales should get service performance comparable to best (retail and wholesale) performers in England. CCWater can contribute to this work through the evidence we gather on customer satisfaction and company performance in Wales.</p> <p>Non-household customers in Wales (ineligible to switch supplier) may also have different priorities or expectations than those in England. Continuing engagement with non-household customers in Wales is needed to ensure their issues are not neglected.</p>
<u>Wholesale/upstream</u>	
Opening markets for water resources (linked to abstraction licence reform) and sludge disposal.	<p>This may improve service performance, efficiency, resilience and innovation, but there must be demonstrable value to customers from the opening of such markets, and any risks to customers are identified and addressed.</p> <p>Ofwat also needs to identify how to protect customers in areas where the market for these upstream activities is less active or not an option (e.g. if this is not taken forward in Wales). These customers may not be getting the benefit of improved services and reduced costs as those in the active market.</p> <p>The design and implementation of such incentives should include an assessment of the potential benefits for customers. This would also need to measure potential environmental benefits, as well as ensuring fairness in the allocation of water.</p>

<p>Use of a system operator in a future water resource/abstraction licence market</p>	<p>We agree that the effectiveness of this market is dependent on the quality of interaction between the parties involved. But whether a system operator is the right model is open to question. Ofwat would need to assess costs v benefits and ease of implementation to demonstrate this is a viable framework.</p> <p>This assessment should include consideration of the potential implications on water quality, particularly where different suppliers may be allowed to input water into the incumbent’s network (especially if it is downstream of the treatment works).</p>
<p>Regulating prices in an upstream market and the potential effect on Regulatory Capital Values (RCVs)</p>	<p>Ofwat needs to model an approach to wholesale access pricing of these two markets to look at the pros and cons of Ofwat’s options for cost assessment (cost avoided or cost included) and how specific local costs are taken into account (including whether average pricing should be applied).</p> <p>Consideration should also be given as to how and to what extent RCVs should change when these parts of the wholesale chain are opened up to markets.</p>
<p>Development of competition in other parts of the upstream chain (legislation might be required to enable this).</p>	<p>This will be led by Government policy and/or legislation, but market opening for other parts of the wholesale chain should be focussed on added value for customers, sector stability, environmental protection and resilience. Future proposals should have an impact assessment to explore this.</p>
<p><u>New Appointments and Variations (NAVs)</u></p>	
<p>Ensuring customers benefit from a NAV arrangement within an incumbent’s area of supply.</p>	<p>NAVs should provide services and prices to consumers that meet, and are ideally better those of the incumbent water company, without having a detrimental effect on the customers of the incumbent. CCWater considers that the incumbent’s customers outside of the new appointment must be protected so that they do not pay a cross subsidy or suffer detriment.</p> <p>CCWater will continue to seek reassurances that the initial benefits to NAV customers are sustainable, and clarity that the new appointments mechanism will benefit customers in the longer term. Ofwat and new appointees should make clear the benefits that the new appointments system brings to consumers and the environment, and to ensure that these benefits are tangible, sustainable and well communicated.</p>

Discussion paper 4: Policy issues - regulating monopolies

Challenge faced by the water/wastewater sectors	CCWater view on how Ofwat should deal with these issues
<u>Breaking down price controls further</u>	
Introducing separate price controls for parts of the wholesale chain when competition may be introduced.	There should be transparency and effective allocations of wholesale costs to enable separate price controls. Ofwat should not lose focus on the combined customer bill impact of various price controls beyond just retail and wholesale only.
<u>Incentivising wholesale cost efficiency</u>	
Use of ‘enhanced’ status for business plans, possibly increasing rewards to drive better quality business plans.	Ofwat needs to demonstrate that the customer benefits of ‘enhanced’ status outweighs the cost of the reward (reward includes higher cost of capital and, in some cases, less ambitious performance commitments). Past performance should also be a key factor when assessing a business plan for this status ²⁰ .
Modelling costs and setting efficiency ‘baselines’	In its provisional findings on Bristol Water’s appeal of its 2014 Final Determination, the Competition and Markets Authority has highlighted issues with PR14 cost modelling ²¹ . Ofwat should develop its PR19 cost models using ‘lessons learned’ from PR14.
<u>Setting retail price controls and assessing retail costs</u>	
Household retail - evolving the ‘average cost to serve’ (AVS) approach	AVS was a starting point for retail price controls at PR14, but there should be a gradual move toward setting retail price controls on ‘most efficient cost to serve’ in the future ²² . Ofwat should only allow adjustments for well evidenced exceptional and unavoidable costs.
<u>Risk and reward</u>	
Balance of risk and reward	Ofwat should address the imbalance of risks and rewards between companies and their customers. We consider that the index linking of Regulated Capital Values and wholesale prices, coupled with an over estimation of risk in the equity beta component of the cost of capital, means that companies and their investors are over protected from risks to the detriment of customers. While customers may eventually obtain a share of cost efficiencies, more could be done to

²⁰ See section 4.2 of our assessment of the 2014 price review, ‘A Step in the Right Direction’ (2015) [here](#).

²¹ See the CMA provisional findings [here](#).

²² For more detail see section 5 of our response to Ofwat’s consultation on its framework for setting 2015-20 price controls (2013) [here](#).

	ensure customers no longer over compensate companies given the level of risk in the sector
Indexation of RCV - which form of index is the right one?	The current independent study of indexation options is due to complete in early 2016 ²³ . The conclusions of this study should be followed by further discussion as to the appropriate indexation to use - not just for RCVs, but for wholesale price controls more generally.
<u>Financial stability and resilience</u>	
Dealing with risks associated with company structures	<p>We are concerned about the level of gearing in a number of companies' financial structures and the risks this may have for customers. We would be concerned if customers were asked to 'bail out' companies that have chosen to gear up in the past, often rewarding their shareholders in the process.</p> <p>Therefore we support Ofwat's finance monitoring framework to analyse structures and performance, and the use of stress tests to ensure risks are identified and addressed²⁴. Ofwat should be clear on its options for intervention if issues emerge.</p> <p>We would welcome the addition of company tax arrangements in this monitoring regime. Companies should be challenged to be both transparent and explain if, and how, tax savings are beneficial to customers.</p>
Duration of a price control period	Longer price controls may affect investor confidence and price up the cost of capital. It is possible to retain five year price controls but set in the context of a longer term strategy. Five yearly price reviews within this long term context can also allow for an assessment of whether any objectives in the long term strategy needed to change due to new evidence.

²³ UKSA review of consumer price statistics. For details, see [here](#).

²⁴ For more detail, see CCWater's response to Ofwat's consultation on its proposed financial monitoring framework (2015) [here](#).