



# Hafren Dyfrdwy /Severn Dee Customer Challenge Group

Report to Ofwat  
on Hafren Dyfrdwy's  
*Revised* Business Plan for 2020-2025



1 April 2019

## Glossary of Acronyms

AMP6	Asset management plan 2015 to 2020
AMP7	Asset management plan 2020 to 20205
CAPI	Computer Aided Personal Interviewing
CBA	Cost benefit analysis
CCG	Customer Challenge Group
CCWater	Consumer Council for Water
DCWW	Dŵr Cymru Welsh Water
DWI	Drinking Water Inspectorate
HD	Hafren Dyfrdwy
IMD	Index of Multiple Deprivation
NDA	Non-Disclosure Agreement
NRW	Natural Resources Wales
NAV	New Appointments and Variations
NEP	National Environment Programme
ODI	Outcome Delivery Incentive
Ofwat	Water Services Regulation Authority
PR14	Price Review of 2014
PR19	Price Review of 2019
ST	Severn Trent
PC	Performance Commitment
UKWIR	UK Water Industry Research
WACC	Weighted average cost of capital
WASC	Water and sewerage Company
WG	Welsh Government
WOC	Water only Company
WRMP	Water Resources Management Plan
WTP	Willingness to pay
WTW	Water treatment works
WWTW	Waste water treatment works

### Disclaimer

This document has been produced by the Customer Challenge Group (CCG) of Hafren Dyfrdwy (HD) specifically for issue to Ofwat to aid Ofwat's assessment of the HD Business Plan for 2020-2025. The document has been produced by the CCG based on the evidence provided to it by HD. The CCG recognises the need for further detailed challenge by Ofwat on those elements of the Business Plan unseen by the CCG and beyond its remit and competence. It is noted that the ability to deliver against the objectives and outcomes set is reliant entirely on whether the company has made sufficient provision in its financial calculations and is able to deliver against its Business Plan, and the outcome of the final determination. The document and/or its contents are not intended for use or to be relied upon by any other party.

# Contents

<b>Executive Summary</b>	<b>4</b>
<b>1.0 Purpose</b>	<b>5</b>
<b>2.0 Introduction</b>	<b>5</b>
<b>3.0 Initial Assessment of Plans</b>	<b>6</b>
<b>4.0 CCG Assurance – Addressing Affordability and Vulnerability</b>	<b>7</b>
4.1 Affordability and Acceptability of the Business Plan	7
4.2 Customer Engagement on Long Term Bill Profiles	8
4.3 External/Peer Review and Third Party Assurance	9
<b>5.0 CCG Commentary on other areas of interest</b>	<b>10</b>
5.1 Customer Support for Social Tariff Cross Subsidy	10
5.2 Performance Commitments – General	10
5.3 Effectiveness of Affordability PC	11
5.4 Delivering Outcomes for Customers	11
<b>APPENDIX A</b>	
Chronology of CCG involvement post IAP	<b>14</b>

# Summary

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Hafren Dyfrdwy and the CCG have worked diligently since the Initial Assessment of Plans (IAPs) were published on 31 January 2019 to ensure the resulting activities undertaken by the company have been as robust and effective as possible to deliver the outcomes that customers want at a price that they can afford.

Overall the CCG is content that the approach undertaken by Hafren Dyfrdwy - in new areas of research; using quantitative, qualitative and deliberative techniques; in a variety of locations; and engaging a good cross section of customers bilingually - was both appropriate and robust *given the time allowed*.

The CCG believes that the process would have benefitted greatly from more time in which to comment on the research design, to analyse the resultant findings and to challenge the company further on their interpretation of the results. This would have helped the CCG better understand the company's triangulation of their research findings, new and old, leading to some of the revisions contained within the Business Plan. The company has provided further information to CCG members in this regard. It has updated them with interim research results, updates, summaries and full reports when they have been available. Robust discussions have taken place at CCG meetings in emails and telephone calls to ensure the best possible outcome from the process, and to assimilate the final research findings. A comprehensive review of the company's recent activity 'in the round' by the CCG in a formal meeting was simply not possible in the time available and the CCG's comments are therefore limited to areas on where it has been able to challenge and on which it feels confident to offer comment. Thankfully the areas on which Ofwat is seeking CCG assurance can be positively addressed.

The CCG remains frustrated with the short window of opportunity in which the company had to undertake additional customer engagement to update/validate its' Business Plan and for the CCG to be able to offer constructive challenge, feedback, reflection and assurance. This is not meant as a criticism of the company who endeavoured to ensure CCG involvement throughout the process as time could allow. It is a comment on the reality of the situation. That said, at its last meeting on the 13 March, the CCG had no unresolved challenges to the main issues identified at that time.

The CCG hopes that the challenges brought about by such short timescales will not jeopardise the long and extensive engagement that has taken place over the last two years or so between the company and customers. The views of customers, even when they are sometimes at odds with the expected format or models proposed for the delivery of the 2020-2025 business plans, must be treated with respect. As the interpretation of research can be very nuanced, the CCG urges caution not to necessarily conflate a customer's 'value', 'priority' or 'importance' placed on a service area with their willingness – or indeed ability – to pay for (out)performance

in such areas. The affordability issues for Welsh customers served by HD are also very real. There is risk that any imposition by a third party which may effect a material change to actions supported (or not supported) by customers could harm future meaningful engagement with customers.

## 1.0 Purpose

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This report has been produced by Hafren Dyfrdwy's (HD) independent Customer Challenge Group (CCG) following Ofwat's extensive and detailed assessment of the company's initial Business Plan for 2020 – 2025 as submitted on 3 September 2018.

The report aims to outline the CCG's engagement with the company in addressing the areas of the Business Plan on which Ofwat seeks the Customer Challenge Group's assurance.

## 2.0 Introduction

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In its report to Ofwat in September 2018, the CCG highlighted several areas of support for the activities and practices of Hafren Dyfrdwy in their approach to customer engagement as it developed the business plan for 2020-2025, as well as areas where it urged caution where future work was required.

The Initial Assessment of Plans undertaken by Ofwat has led to further engagement with the CCG to strengthen the plan in several areas. The main challenge faced by the company and the CCG was the extremely constrained timescale in which to revisit existing research, to design and commission new research and, importantly to analyse the findings and to amend areas of the Business Plan accordingly. The CCG's activity during this time included formal meetings, attendance at workshops and research events, email discussions, conference calls and face to face meetings with stakeholders as summarised in Appendix A.

## 3.0 Initial Assessment of Plans (IAP)

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Ofwat's assessment of HD's Business Plan placed in it the 'subsequent scrutiny' category, the lowest category available, highlighting that there are a number of areas where the company needs to undertake further work.

The CCG was pleased to note that Ofwat commended the company on its sector-leading performance on costs which it hopes will have a substantial benefit to customers and help deliver affordable bills. There was, however, a relatively extensive list of actions requiring further attention by the company.

This report will not offer a comment on all the actions required of the company by Ofwat. Rather it will focus on the two main areas where Ofwat indicated the views and assurance of the CCG was required. In addition, the CCG will offer some general comments and observations where it has a particular interest.





## 4.0 CCG Assurance – Addressing Affordability and Vulnerability

Ofwat's document 'Hafren Dyfrdwy: Actions summary table' details the actions the company is required to address when resubmitting its Business Plan. Within this there were two areas where Ofwat specifically requested assurance from the CCG.

### 4.1 Affordability and Acceptability of the Business Plan

Action reference	Action type	Date Required
HDD.AV.A1	Required	1 April 2019
<p><b>Action:</b> Hafren Dyfrdwy has proposed a higher bill than what it tested with customers in North Wales. A bill profile with an increase of 1% was tested in North Wales. However, an increase of 3.7% was submitted in the business plan for this area. Hafren Dyfrdwy should provide sufficient and convincing evidence that it has engaged with its customers on affordability and acceptability of its proposed bills and bill profiles for the 2020 to 2025 period. Hafren Dyfrdwy should demonstrate that its customers find its proposed bill and bill profiles acceptable and affordable. This should include testing its proposed bills and bill profiles for the 2020 to 2025 period with both the regions it serves. <b>Hafren Dyfrdwy should confirm that testing has been assured by its CCG and conducted in line with social research best practice.</b></p> <p><b>CCG Response:</b> Hafren Dyfrdwy made a change to their proposed bill profiles in August 2018. The revised bills were re-tested in Mid Wales but not in North Wales which was of concern to the CCG.</p> <p>Since the submission of the Business Plan in September 2018 the company have undertaken the acceptability and affordability research in North Wales and <b>the CCG is satisfied that it was conducted in line with social research best practice.</b></p> <p>The research material for both the Mid Wales research and the North Wales re-test was presented to the CCG by the company. The CCG's comments in relation to structure, format and tone were taken on Board by the company and it is pleased that the information provided to the customers included figures with and without inflation.</p> <p><b>The CCG are satisfied with the company's process and practice when undertaking this research in both Mid and North Wales and there is no outstanding action from the CCG on this item.</b></p>		

**CCG Observations:** The CCG was interested to note some considerable differences in the responses to both the acceptability and affordability of the plan between the two discrete areas that make up Hafren Dyfrdwy.

The CCG welcomed the customer segmentation undertaken by the company as part of the acceptability and affordability research to gain a better understanding of the impact of the plan on the various groups of customers. In particular the impact on the Just About Managing (JAMS) groups of customers is an area for ongoing monitoring.

In North Wales the overall acceptability of the proposed plan in nominal terms was disappointingly low at 51% with nominal affordability also low at 51%. The CCG were particularly concerned with the very low figures for acceptability and affordability (when expressed in nominal terms) for the Just About Managing (JAMS) cohort of customers in North Wales, being 24% and 22% respectively.

In Mid Wales, acceptability of the plan was generally well supported by total customers as well as the JAMS in both real and nominal terms. However, the affordability of the plans a whole remains low with just 53% of the total customers finding it affordable and only 39% of JAMS finding it affordable (in nominal terms). It is also worth remembering that these figures do not account for any future bill increases due as a result of outperformance payments that may accrue through the ODI mechanism in 2020-2025.

## 4.2 Customer Engagement on Long Term Bill Profiles

Action reference	Action type	Date Required
HDD.AV.A3	Required	1 April 2019
<p><b>Action:</b> Hafren Dyfrdwy has not provided evidence to demonstrate that it has tested bills or bill profiles beyond 2025, particularly for the 2025-30 period, with customers. Hafren Dyfrdwy should undertake customer engagement on long-term bill profiles for the 2025-30 period and provide sufficient evidence to demonstrate customer support for each of the profiles tested. <b>Hafren Dyfrdwy should confirm that testing has been assured by its CCG and conducted in line with social research best practice.</b></p>		
<p><b>CCG Response:</b> The company has revisited its Asset Health, Resilience and Intergenerational Fairness research project which informed the initial business plan, and which included two deliberative workshops (39 consumers) where a mix of both future bill payers and current bill payers were in attendance.</p> <p>An additional research project 'Fair balance of charges' comprised two deliberative workshops (one in Mid Wales and one in North Wales) with current bill payers (at a range of ages and life stages), who were asked their views on two different potential bill profiles (with and without levers) up to the year 2035.</p> <p>In the new ODI Choices (quantitative) research, the company also specifically sought to include the views of some future bill payers.</p> <p>This research was carried out by Britain Thinks in both Wrexham and Powys. The design of the research and the findings were shared with the CCG and peer reviewed.</p>		



The CCG had the opportunity to comment on the research material and attended one of the workshops. The research findings were discussed with the CCG who welcomed consultation on a range of options to balance future bill profiles. The CCG has also seen the peer review of the company's approach and it is satisfied that it was carried out in accordance with best practice, given the time available.

### 4.3 Peer Review and Third Party Assurance

The CCG is pleased to note that much of the company's research has been externally reviewed/peer reviewed. The CCG has had the opportunity to read the peer review regarding the 'Quality of customer research' by Mike Stevens, Managing Director of What Next Strategy & Planning (as recommended by Research Chair of Severn Trent CCG) and it is aware of other reviews as follows:

- Use of customer research and triangulation – Frontier Economics
- Designing ODIs – Frontier Economics
- Interpretation of social tariff and acceptability research – Frontier Economics
- Resilience – Arup
- Financial modelling and financeability – Jacobs
- Tax – PWC
- Past performance – Black and Veatch
- Data tables – Black and Veatch and Severn Trent's Internal Audit team



# 5.0 CCG Commentary –

## Other areas on which the CCG would like to offer some observations and comment

The CCG would like to offer some comment/observations on other areas of the revised Business Plan.

### 5.1 Customer Support for the Social Tariff Cross-Subsidy

Test Area	Addressing affordability and vulnerability	
Action reference	Action type	Date Required
HDD.AV.A4	Required	1 April 2019
<b>Action:</b> Hafren Dyfrdwy has not provided sufficient evidence on the level of cross-subsidy for social tariffs in its business plan. Hafren Dyfrdwy has also not provided sufficient evidence on support for this cross-subsidy across its customer base. Hafren Dyfrdwy should provide evidence on the level of cross-subsidy proposed and the support level for this cross-subsidy across its customer base.		
<b>CCG Response:</b> The CCG in general, and the CCWater representative in particular, was consulted regarding the company's approach to designing the social tariff with its customers and in evidencing support for the cross-subsidy. Whilst the company had previously been criticised by the CCG for only having held an initial co-creation event in Wrexham, it has since been convinced that subsequent <b>events and customer engagement have been undertaken equitably across the region.</b>  The research findings demonstrated different reactions in each of HD's discrete regions to the proposals which were discussed at length with the CCG. The resultant figures chosen were supported by upwards of 80% of customers in both North Wales and Mid Wales however and the CCG were content with this approach. <b>The CCG consider that the figures proposed by the company in setting the social tariff cross-subsidy are an informed and balanced reflection of customers' views as a whole.</b>		

### 5.2 Performance Commitments

The CCG welcomes the introduction of the PC related to the number of customers on HD's Priority Services Register (PSR) of 7% and the new performance commitment covering the resilience of services (source resilience).

The CCG notes the increased ambition by HD for four of the measures – supply interruptions, pollution, blockages and internal sewer flooding. We also note the remaining five measures (PCC, drought risk, unplanned outage, lead pipe replacement and effectiveness of affordability) have been represented in the revised

business plan using more evidence to address the IAP actions, but that no change to the PC targets have been made.

### 5.3 Effectiveness of Affordability

The CCG welcomes HD's approach to developing a new and innovative PC that aims to gauge the effectiveness of the company's affordability interventions (outcomes) and not just to count the numbers on its schemes (inputs).

We note Ofwat's suggestion in the IAP to remove this PC given the lack of data currently available. The CCG fully recognises the early stage in gathering baseline data for this PC, but it remains of the strong opinion that this is no reason for 'demoting' such an important area of activity both for the company and for its customers. Maintaining Effectiveness of Affordability as a PC publicly demonstrates the importance of this area of work.

**The CCG is therefore very supportive of the HD's approach to target outcomes rather than inputs in relation to affordability. It supports the company setting the target for this specific measure based on stable performance in AMP7 so that it has the time to set a baseline and understand the drivers of performance so the company can target bigger improvements in AMP8 and beyond.**

### 5.4 Delivering outcomes for customers

Test Area	Delivering Outcomes for Customers	
Action reference	Action type	Date Required
HDD.OC.A1-55	Required	1 April 2019
<b>Action:</b> The company has a number of actions in relation to its performance commitments, outcome delivery incentives and ODI risk/return package. Please see ' <i>Hafren Dyfrdwy: Delivering outcomes for customers detailed actions</i> '.		
<b>CCG Response:</b> The CCG enthusiastically welcomed specific and discrete research in to the ODI regime which is proposed for 2020-2025. The research sought customer views on <ul style="list-style-type: none"> <li>• The principle of ODIs</li> <li>• How they are designed and applied - whether each service area should be penalty-only, reward-only, both reward and penalty or reputational incentive</li> <li>• The specific value for performance payments – the upper limits payable for rewards and penalties</li> <li>• To understand customers' views surrounding acceptable individual ODI ranges for performance payments for each service area</li> </ul>		

- The timing of rewards - to understand whether customers think that performance payments should apply at the end of each year, or at the end of the AMP.

The CCG commented on the research material, along with its presentation, and the company accommodated just about all of the challenges made (these are included within the HD updated Business Plan document at Appendix 2.12). The methodology (CAPI), use of different locations, use of demographics and extension to include non-household customers was also **welcomed by the CCG who felt the research was robust and carried out in accordance with best practice *given the time available*. This research was also peer reviewed.**

**However**, the evidence from the ODI customer research shows that, from an uninformed perspective, there is not a resounding endorsement of ODIs. **Only 30% of customers agreed with the principle.**

Nevertheless at individual PC level there appears to be a small majority of customers that may support rewards and penalties when applied to certain PCs. The company has used this evidence to help bridge the gap between Ofwat's desire for a stronger alignment between investors and customers, whilst seeking to reflect overall customer concerns about the use of ODIs and affordability.

This does lead to a RoRE upside below the indicative range (0.5% versus Ofwat's guidance of 1-3%) however. In turn, this raises a question with which the CCG continues to grapple - what should be given greater weight, the customer view or the indicative range?

The CCG will leave Ofwat to reach a conclusion but suggests that the answer ought not be reached without re-considering the impact of ODIs in tandem with customers' views on the affordability of the plan (in nominal terms) being only 51% for North Wales and 53% for Mid Wales. These figures were for a plan *net* of the application of any ODI rewards<sup>1</sup>.

**CCG Observations:** In its response to Hafren Dyfrdwy's initial plan the CCG was concerned with the level of customer engagement undertaken by the company when deciding on the ODI package – the type of incentive, the rate to be applied and the protections for customers. In its assessment of HD's ODI proposals Ofwat also felt that the company's performance commitments were not sufficiently stretching. It also felt the proposed outcome delivery incentive rates were low compared to the rest of the industry with the overall package being much smaller than the indicative range for return on regulated equity (RoRE). Ofwat was unclear as to how Hafren Dyfrdwy's ODI package would incentivise the company to improve performance, or how it aligned the interests of customers and shareholders.

<sup>1</sup> The low affordability in Powys raises concerns for CCWater as to the effect the application of deferred PR14 ODIs over AMP7 will have on customers.

The general tone of Ofwat's criticism of the company's proposed package was that it was not ambitious enough to incentivise the company to perform better in areas of importance to customers. It also criticised the lack of customer support evidenced for the proposed ODI package.

At its last full meeting on 13 March 2019, the initial results of the quantitative research were presented to the CCG and it was clear that the appetite of HD customers for the ODI mechanism was practically non-existent. Indeed, **only 30% of agreed 'with the principle that a small amount of a customer's bill should be linked to the level of service customers receive'**. Responses demonstrated a clear lack of support for the mechanism and the appetite for penalties, although slightly more supported than reward payments, were also not overtly desirable.

The company then decided to commission qualitative ODI research to better understand customer views. Given the extremely short timescale left, the CCG were unable to be consulted on the material used in the research<sup>2</sup> and was not fully briefed on this qualitative ODI research findings and the rationale for some of the changes made to ODI types and rates.

At the interim results stage of the process, the CCG had understood that the company would not be applying any reward financial incentives to their ODIs as they could not be justified from the findings of the ODI quantitative customer research<sup>3</sup>. However, there is a real risk that a Business Plan with an absence of financial incentives would not fulfil the Ofwat model.

The CCG understand that the company has interpreted and triangulated these findings in its revised Business Plan in an attempt to better align its proposed ODI package with Ofwat's model where rewards and penalties are seen as the only way that customers' priorities can be met.

However, given the overt lack of support for either the reward or penalty aspect of the ODI mechanism – and given the issues of affordability for a not insignificant number of HD customers - the CCG remains unconvinced that Ofwat's model and ODI regime can reflect what the customer evidence is clearly showing.

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<sup>22</sup> Undertaken by Britain Thinks.

<sup>3</sup> Undertaken by DJS research.

# APPENDIX A

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## CCG Formal Meetings since Independent Assessment of Plans on 31 March 2019

Date	Issues Discussed
12 February – meeting (all day) Powys	<ul style="list-style-type: none"><li>• IAP Ofwat Feedback</li><li>• HD's proposed approach to responding to feedback</li><li>• HD's proposed approach to seeking expert assurance to review the validity of their original submission</li><li>• results of additional research on acceptability testing and through 6 monthly customer survey</li></ul>
18 February - call	Discuss changes made to the ODI choices research and to address CCG feedback
12 March – meeting (all day) Wrexham	<ul style="list-style-type: none"><li>• Share initial findings from HD's quantitative ODI research</li><li>• Share approach to qualitative ODI research</li><li>• Share findings from long term bill research</li><li>• Confirm and challenge proposed changes to PCs</li></ul>

A full log of the specific challenges made by the CCG (and subsequently by CCWater) along with the response of the company to those challenges is set out in appendix 2.12 of HD's revised Business Plan.