

Realising the opportunity

Final Report

Review of Independent Challenge Groups in
the water sector

For the Consumer Council for Water

March 2024

Contents

Foreword from CCW	1
Executive summary	2
Acknowledgement	6
1 Introduction	7
1.1 Terms of reference.....	7
1.2 Sector context.....	8
1.3 Approach to the review.....	8
1.4 Structure of this report	9
1.5 Audiences.....	10
2 Why customer challenge matters	11
3 ICGs' potential to enhance customer challenge	13
4 Strength of the customer challenge arrangements	15
5 Evidence from the PR24 arrangements for customer challenge ..	19
5.1 Effect of removing the mandate.....	19
5.2 Independence of the ICGs.....	24
5.3 Constitution, role clarity and capacity	26
5.4 Membership and expertise	28
5.5 Resourcing and remuneration.....	31
5.6 Board Access.....	34
5.7 Visibility of the ICG's work	36
6 Recommendations: a proposed framework for ICGs	37
6.1 Governance	37
6.2 Scrutiny remit	39
6.3 Guidance	40
6.4 Information	41

Appendix A – Terms of Reference	42
Appendix B – Phase 2 research process.....	44
Appendix C - Checklist for effective ICG challenge.....	45
Appendix D - Topics scrutinised by ICGs	46

Foreword from CCW

CCW commissioned Indepen to carry out a two-part review of the challenge arrangements that water companies put in place for the 2024 price review (PR24). The aim was to assist Independent Challenge Groups (ICGs), learn from best practice and strengthen their challenge to the companies.

This review was carried out in the context of CCW, ahead of PR24, stating that we thought *“local representation is necessary”*. We wanted local representation to *“deliver for customers”* and *“produce outputs and achieve outcomes that are valued by both companies and Ofwat.”*¹

Indepen’s review will help CCW, and others determine how successful ICGs have been in delivering for customers. Phase one² of the review looked at the strengths and weaknesses of the various arrangements and it is clear from this report that many ICGs adapted their approach to reflect the phase one recommendations.

The second part of Indepen’s review considers the overall strength of the ICG challenge arrangements at PR24 and provides recommendations for effective local challenge in the future. This includes a framework for Ofwat and companies to consider when designing arrangements for future price reviews, if ICGs are considered to be the appropriate model for local challenge.

This report, while commissioned by CCW reflects Indepen’s view. CCW will use Indepen’s review to inform our own lessons learned work for PR24 as we consider what local challenge arrangements can deliver the best outcomes for all customers. As part of our 2024/25 work programme we will be considering how best to involve customers in decision making.

Jenny Suggate

Director of Policy, Research & Campaigns

CCW

¹ [Future Consumer Representation Models: A CCW Discussion Paper June 2021](#)

² [Indepen: Influencing Without Power – a review of Independent Challenge Groups in the Water sector. February 2023](#)

Executive summary

Objectives of the review

The Consumer Council for Water's (CCW's) aim in commissioning this review was to help the Independent Challenge Groups (ICGs) make their challenge to the water companies more effective. CCW intended the review to inform Ofwat's assessment of the quality of the challenge to company plans at PR24 and provide lessons for effective future customer challenge arrangements.

In developing the review's Terms of Reference, CCW considered Ofwat's expectations of how customer challenge would be evidenced in PR24 planning. Key parts of this were the independence of the ICGs, their membership and expertise, resources, board access, constitution and clarity of role, and transparency.

Phase 1³ covered the approach taken by companies and their ICGs since the submission of the PR19 business plans. The requirement for the companies to have challenge groups ended at this point. Phase 1 drew conclusions about the structural, governance and behavioural factors that result in effective scrutiny and challenge and identified risks to effective challenge inherent in the arrangements adopted by some of the companies.

Phase 2 has examined

- how the companies and ICGs have responded to the Phase 1 conclusions and recommendations and
- how successful the companies' different ICG arrangements have been in the lead up to the submission of the PR24 business plans to Ofwat on 2 October 2023.

Approach

The research for each phase included a questionnaire to the ICG Chairs; review of ICG documents (Terms of Reference, meeting minutes and reports); interviews with the ICG Chairs and with one or more representatives from each water company. Phase 1 included interviews with independent non-executive directors from several water companies. Phase 2 included a workshop with the CCW representatives on a selection of ICGs. The research was qualitative, and the results are presented accordingly.

The role of customer challenge

ICGs' challenge to the water companies should be considered in the context of why customer challenge matters. Customers' awareness of and contribution to the water system and what is

³ Indepen for CCW 'Influencing Without Power: A Review of Independent Challenge Groups in the Water Sector' (February 2023).

considered acceptable is important not only for customer satisfaction and public trust, but also how the system operates and for attracting investment.

The monopoly granted to water companies means that customers cannot change their supplier. This is the justification for the economic regulation of the sector. It is reasonable to ask whether Ofwat's powers with access to the results of customer engagement and research it and the companies might undertake gives the customers of the water monopolies sufficient say in decisions and outcomes that affect them and sufficient opportunity to challenge them. The current performance of the sector suggests that in recent times, the regulatory arrangements alone have not been sufficient to ensure an adequate voice for customers in the delivery of their priorities⁴. Regarding customer engagement and research, while the design and execution of these programmes have become more sophisticated, the interpretation of the results is still subject to well-known problems in the context of complex situations such as water services, particularly whether participants were provided with sufficient context and questions that enable them to provide meaningful responses.

For PR24 business planning, Ofwat required companies to demonstrate that customers and their representatives are '*able to challenge the companies' ongoing performance, business plans and long-term delivery strategies*'⁵. Despite there being no requirement to have a challenge group, all but one company opted to have one. The other appointed an independent individual.

Conclusion on the strength of the customer challenge arrangements

It was clear from both phases of the research, as well as from the ICGs' reports on PR24 business planning, that there is a substantial record of ICGs successfully challenging companies to do more to respond to customers' needs and priorities. All the ICG Chairs and company representatives were able to cite instances where the ICG's input had improved the quality of the customer research and engagement or the proposals in the plan, or both.

The arrangements adopted for ICG challenge varied between the companies.

- Some companies applied Ofwat's '*expectations for the standards that should be achieved*'⁶ rigorously, appreciating the benefits of real challenge from their ICG
- Others adopted looser interpretations that resulted in less challenge
- A few company representatives said they had taken the opportunity to implement a lighter touch approach to scrutiny
- There was significant variation in the aspects of business planning that were scrutinised, in the level of rigour ICGs were able to apply and in companies' willingness to respond to challenge

⁴ The Overall Categorisation table in Ofwat's latest Water Company Performance Report (Ofwat, 'Water Company Performance Report 2022-23' page 5) shows that, out of 180 metrics across the 17 companies, more than half (96) were "*poorer than performance commitment level*".

⁵ Ofwat, 'PR24 and beyond: Customer engagement policy – a position paper' page 8 (February 2022)

⁶ Ibid

Consequently, the strength of the ICG challenge and the effect it had on the company's plans varied between the companies.

Without a mandate, the ICG operates at the discretion of the company and the company can limit the level of the ICG's scrutiny even though Ofwat has set out its 'expectations'. Cases where both the ICG Chair and their company counterpart said the ICG's challenge was consistently effective and added significant value were companies that actively welcomed challenge. These ICGs were well resourced in terms of membership, time allocated, and information provided and were also able to drive the selection of areas for scrutiny. Others were allocated a limited role or resources, or both, by their companies, and this limited the effectiveness of their challenge.

At the same time, there is evidence that Ofwat's decision to provide '*flexibility for companies to design their own approaches to meet their own specific needs and ambitions*'⁷ has enabled innovation in ICG structures, membership and remits. Given the variation between water companies across numerous dimensions including size (customer numbers, lengths of main), geography and environment, water sources, population distribution, demographics and asset age, it is essential that companies have the freedom to design their own approaches to customer challenge, including ICGs.

There is an opportunity to enable consistently high quality ICG challenge by addressing some features of the current arrangements and applying the learning on facilitating effective challenge. We have proposed a framework of criteria for how this could be done.

Proposed framework for ICGs

ICGs have the potential to be a resource for regulators and statutory bodies. They could play a complementary role by following up on regulatory scrutiny and reporting, thus enhancing the impact of the regulatory and statutory bodies. ICGs could also play a part in rebuilding trust in the sector. This potential follows from the features of the ICG, which

- is focused on one company
- has regular, often frequent, contact with that company
- is able, subject to its remit, to examine business plan commitments and the company's delivery of those commitments in depth, early and over time
- has a specific role on behalf of customers and acts solely to reflect customers' interests
- is independent with members who bring an external perspective, questioning accepted practice and contributing lessons and best practice from other sectors
- can establish itself as a trusted critical friend with the company responsive to its challenge.

⁷ Ofwat, PR24 and beyond: Creating tomorrow, together: Appendix – Reflecting customers' preferences, page 14-15 (May 2021)

Our proposed framework is intended to enable consistently high quality ICG challenge to all water companies. It addresses the power and information imbalances that currently limit the effectiveness of many ICGs. It supports continuing the freedom for companies to design their ICG to suit the circumstances of the company and its customers.

Ofwat setting a mandate and core scrutiny remit would not only provide clarity, it would enhance the ICGs' standing with their companies, adding weight to their challenge and recommendations. Companies less committed to customer challenge can currently regard these as 'optional'.

The framework (set out in full at Section 6) has four elements:

- Governance: four mandatory essential elements
 - the ICG has an independent chair
 - the company board is accountable for enabling, and listening to, the ICG's challenge
 - the ICG is to be ongoing, scrutinising both business planning and delivery
 - companies to publish annual reports from the ICG including a challenge log
- Core scrutiny remit: for each price control period, to include
 - the design and delivery of business plan commitments, including but not limited to performance commitments
 - the design of the company's customer engagement and research and the company's responses to the findings, including triangulation with other factors
 - the company's explanation of how it plans to respond to important customer concerns
 - the company's customer behaviour change programmes
- Guidance: evidence-based best practice re the structural, governance and behavioural factors that together facilitate effective challenge
 - drawing on the learning from this review and other sources
 - developed by CCW, which has the greatest direct experience of challenge groups, reviewed their operation at both PR19 and PR14 and commissioned this review
- Information: consistent regulatory information, and shared learning
 - consistent, timely provision of data and information to ICG Chairs by the regulators
 - sharing best practice and learning between the ICG Chairs
 - using the Challenge Co-ordination Group (COG) of ICG Chairs convened by CCW

Acknowledgement

CCW proposed that this review should be collaborative, noting that ‘it will require the support of ICG Chairs – and companies – to deliver the best outcome’. That support has been forthcoming in both phases of the review. We are grateful for the time that ICG Chairs, company representatives and independent non-executive directors (INEDs) made available for interviews and, in the case of ICG Chairs, completing two questionnaires and providing relevant documentation. A number of CCW representatives who attend ICGs have provided input, as did several Environment Agency representatives in Phase 1. All contributors have provided insights into how the ICGs are working, views on how well the ICG-water company relationship is delivering against its potential and what the role for ICGs going forward could include. The findings of our research have provided an evidence base which makes it possible to identify the elements that constitute best practice and the potential for ICGs to make further contributions.

1 Introduction

This covers the terms of reference for the review, the sector context, our approach to the review, the structure of the report, and the audiences who may find it of interest.

1.1 Terms of reference

The Consumer Council for Water's (CCW's) aim in commissioning this two-part review was to assist Independent Challenge Groups (ICGs) and help strengthen their challenge to the water companies.

Ofwat's February 2022 position paper, *PR24 and beyond: Customer engagement policy*⁸, set out its expectations for customer challenge.

'The purpose of customer challenge is for companies to receive feedback on what issues matter to customers, what their views are on various aspects of companies' activities, and to enable customer comment on how well plans reflect their needs, priorities and preferences'.

In developing the review's Terms of Reference, CCW considered Ofwat's expectations of how customer challenge would be evidenced in PR24 planning. Key parts of this were the independence of the ICGs, their membership and expertise, resources, board access, constitution and clarity of role, and transparency. We were asked also to cover companies' responses to the removal of the mandate to have a Customer Challenge Group (CCG).

Phase 1⁹ covered the approach taken by companies and their ICGs since the submission of the PR19 business plans. The requirement on the companies to have challenge groups ended at this point. Phase 1 drew conclusions about the structural, governance and behavioural factors that result in effective scrutiny and challenge and identified risks to effective challenge inherent in the arrangements adopted by some of the companies.

Phase 2 has examined

- how the companies and ICGs have responded to the Phase 1 conclusions and recommendations and
- how successful the companies' different ICG arrangements have been in the lead up to the submission of the PR24 business plans to Ofwat on 2 October 2023.

The Terms of Reference set by CCW are in Appendix A.

⁸ Ofwat (n 5) pages 8-10

⁹ Indepen for CCW (n 3)

1.2 Sector context

Judgements about the role and effectiveness of ICG challenge should have regard to the complexities of the water sector and its current prominence in the spotlight of public attention.

There are sixteen licensed water undertakings in England and Wales and significant variations in their size (customer numbers, lengths of main, capital employed), geography and environment, water sources, population distribution, demographics and asset age. Additionally, there are differences between companies operating in England and those operating in Wales and between Water only Companies (WoCs) and those also responsible for managing wastewater, the Water and Sewerage Companies (WaSCs).

The background to PR24 business planning was highly charged, with tension between the need for more infrastructure investment to serve the interests of customers now and in future and other demands on customers' budgets. Making trade-offs that broadly satisfy most stakeholders and customers was inevitably going to be difficult. Much of the expenditure incurred by the water companies, including the great majority of expenditure related to the environment, is determined by licence obligations and the associated regulation, administered by the statutory regulators. This means that the companies have discretion to respond to customer needs and preferences in some, but not all, areas.

1.3 Approach to the review

Due to the complexities of the sector and the diversity of ICG arrangements across the companies, we concluded that it would be inappropriate to test the arrangements against a single template of how an ICG should operate. Instead, in Phase 1 we sought to understand how the ICGs were working, and how successful they were seen to be in delivering constructive, influential challenge to the company. From this, we distilled a view of the structural, governance and behavioural factors that allowed an ICG to add value in ways that the company would not get from other sources. The Phase 1 report¹⁰ identified barriers to this, and risks in some companies' arrangements. This was reflected in the recommendations, and summed up in the Key Factors for Effective Challenge checklist which is reproduced in Appendix C.

The research for each phase included a questionnaire to the ICG Chairs; review of ICG documents (Terms of Reference, meeting minutes and reports); interviews with each ICG Chair and with one or more representatives from each water company. Phase 1 included interviews with independent non-executive directors from several water companies. In Phase 2 we held a workshop with the CCW representatives on a selection of ICGs.

¹⁰ Indepen for CCW (n 3)

The willingness of interviewees to speak openly was important for the quality of the evidence and the interviews and workshop were conducted on the basis of anonymity. Rather than identify companies or participants, we have set out the evidence by theme and not used direct quotes. The research was qualitative, and the results are presented accordingly.

We have included in the Phase 1 report and in this Final Report, examples of approaches that ICGs and companies have adopted to enhance the effectiveness of their scrutiny and challenge. While individually each of these will not be applicable to every company, they provide a bank of ideas that companies and ICGs can draw on and refine.

The Phase 2 research examined how successful the companies' different ICG arrangements have been in the lead up to the submission of the PR24 business plans to Ofwat on 2 October. This included how the companies and ICGs have responded to the Phase 1 conclusions and recommendations and how the risks to effective challenge played out.

There are variations in naming the Independent Challenge Groups (ICGs). Some are ICGs, some Customer Challenge Groups and other variations refer to Forum or Panel. For consistency, both reports refer to them all as ICGs. One company appointed a single expert rather than an ICG to conduct its independent challenge for PR24. This person is considered with the ICG Chairs in both reports. Both reports refer to the company CEO and immediate reports as the management team.

The evidence base includes over 60 hours of interviews, 35 questionnaires and information from dozens of documents. Our evaluation culminates in considering how the factors that undermine effective ICG challenge can be addressed while at the same time capitalising on the best practice that has emerged from the freedom to design customer challenge arrangements that best fit the particular circumstances of the company's area and customers.

1.4 Structure of this report

The report begins by setting out why customer challenge matters and discussing the opportunity for ICGs to enhance customer challenge and contribute to the water sector rebuilding its reputation.

There is then a summary of the strength of the current customer challenge arrangements.

This is followed by presentation of the evidence from Phase 2 and key points from Phase 1 as they relate to the key questions in the Terms of Reference.

Finally, we propose a framework for achieving consistently high quality customer challenge to all water companies.

1.5 Audiences

CCW has shared our reports with Ofwat and published them in the interests of transparency.

There are several primary audiences for the review and its recommendations. These include Ofwat, as the body that controls whether ICGs are mandated or not, CCW as the body with the greatest direct experience of ICGs (and CCGs) and the convenor of the COG, the ICG Chairs and the water companies and their boards.

Others may be interested in the review, including the Environment Agency (EA), Natural Resources Wales, Natural England and the Drinking Water Inspectorate (DWI) all of which are involved with ICGs in various ways.

2 Why customer challenge matters

Monopoly suppliers

ICGs' challenge to the water companies should be considered in the context of why customer challenge matters. Customers' awareness of and contribution to the water system and what is considered acceptable is important not only for customer satisfaction and public trust, but also how the system operates and for attracting investment. The monopoly granted to water companies means that customers cannot change their supplier. This is the justification for the economic regulation of the sector.

Role of regulation

One of the consequences of the monopoly enjoyed by the water companies is that the sector is subject to regulation by several statutory bodies. While these bodies prescribe much of what the companies have to deliver, there remains significant discretion about what the companies do and how they do it. It is reasonable to ask whether Ofwat's powers with access to the results of customer engagement and research it and the companies might undertake gives the customers of the water monopolies sufficient say in decisions and outcomes that affect them and sufficient opportunity to challenge them.

One of the conclusions of the 2019 National Audit Office report 'Regulating to protect consumers: Utilities, communications and financial services markets'¹¹, which reviewed Ofwat, Ofgem, Ofcom and the FCA, reflects the challenges:

'The regulators in this review have good insight into consumer concerns and issues. However, they are not sufficiently specific and targeted in setting out what overall outcomes they want to achieve for customers, and therefore what information they need to evaluate and report on their overall performance robustly. Regulators are all taking steps to improve how they define, measure and report their performance in protecting customers, but all have further to go to do so in a meaningful way. Until they achieve this, they will not be able to give consumers confidence that they are providing value for money, or adequate overall levels of protection for those who need it.'

The current performance of the sector suggests that in recent times, the regulatory arrangements alone have not been sufficient to ensure an adequate voice for customers in the delivery of their priorities. Ofwat's introduction online to its Water Company Performance Report 2022-23¹² states that

'Each year Ofwat looks at the performance of the 17 largest water and wastewater companies in England and Wales across a set of key performance and expenditure metrics. The information in the report provides transparency for customers, and wider stakeholders, to see how water companies are performing on the issues that matter to them. We set companies stretching performance commitments at the 2019 price review. Three

¹¹ National Audit Office, 'Regulating to protect consumers: Utilities, communications and financial services markets' (March 2019)

¹² Ofwat (n 4)

years into the period, we see some areas where companies are responding to the challenge, but in many areas progress is not being made at the pace required to meet performance commitment levels.'

The Overall Categorisation table¹³ shows that in 2022-23, out of 180 metrics across the 17 companies, more than half (96) were '*poorer than performance commitment level*'.

Customer research and engagement

In addition to the regulatory arrangements, engagement and research plays an important role in enabling companies to understand the needs, preferences and priorities of their diverse customer segments. While the design, coverage, techniques and execution of these programmes have become more sophisticated the interpretation of the results is still subject to well-known problems in the context of complex situations such as the supply of water and waste water services. And questions remain about how far the companies go and should go in responding to the results.

In the Phase 2 interviews, many contributors said they had found the 'Your Water Your Say'¹⁴ (YWYS) sessions required by Ofwat and CCW¹⁵ useful, and several companies said they intended to arrange further sessions. However, the nature of YWYS means it will be limited to a small fraction of customers and attract the presence of campaigning and interest groups. Attendees can raise important questions, but the coverage may be piecemeal rather than looking systematically across business planning and delivery and covering the interests of all customer groups. Furthermore, while each company was required to report to Ofwat on whether it '*did or did not make a change to its plans in response to an issue raised at the first 'Your water, your say' session*'¹⁶ and explain why, companies were not required to take any action in response to challenges raised.

Value of customer challenge

There is evidence that Ofwat and the water companies see value in customer challenge. While Ofwat did not mandate ICGs for PR24 business planning, it did set out its expectations for '*customer challenge on the nature, quality and use of customer engagement*'¹⁷. It asked companies who had not already done so to provide their ICGs' reports following the submission of PR24 Business Plans. Although Customer Challenge Groups were mandated only for the PR19 business planning period, eight companies continued their ICGs without a pause and four others continued their Groups after a hiatus due to changes either at the company, in the ICG's membership or both. Five were disbanded following the submission of the PR19 business plans.

¹³ Ofwat (n 4) page 5

¹⁴ 'Your Water Your Say' sessions were introduced to 'allow customers and other stakeholders to pose questions to their water company about issues that are important to them, including priorities for the future, in a public environment'. Ofwat - FINAL-guidance-document-for-phase-2-Your-water-your-say.pdf (2023)

¹⁵ Ofwat, <https://www.ofwat.gov.uk/water-company-customers-invited-to-your-water-your-say-series-of-public-meetings-with-water-company-bosses/> (March 2023)

¹⁶ Ofwat (n 14)

¹⁷ Ofwat (n 5) page 2

It was clear from both phases of our research, as well as from the ICGs' PR24 business planning reports and challenge and response logs, that there is a substantial record of ICGs successfully challenging companies to do more than originally planned to respond to customers' needs and priorities. ICGs have the potential to be a resource for regulatory and statutory bodies. They could play a complementary role by following up on regulatory scrutiny and reporting, thus enhancing the impact of the regulatory and statutory bodies. ICGs could also play a part in addressing the reputational challenges the water sector is facing.

The following sections of the report set out the opportunity, review how successfully the current arrangements enable ICGs to take it and propose a framework to maximise ICGs' challenge on behalf of customers across every water company.

3 ICGs' potential to enhance customer challenge

Complementing regulatory structures

ICGs have the potential to be a resource for regulators and statutory bodies, playing a complementary role that enhances their impact. For example, if a commitment is not being met scrutinising why this is and challenging on what can be done, scrutinising whether 'best practice' set out by these bodies is being followed and challenging when it isn't, and interrogating the company's reaction to challenges raised in Your Water Your Say sessions and in other engagement.

This potential follows from the features of the ICG, which

- is focused on one company
- has regular, often frequent, contact with that company
- is able, subject to its remit, to examine business plan commitments and the company's delivery of those commitments in depth, early and over time
- has a specific role on behalf of customers and acts solely to reflect customers' interests
- is independent with members who bring an external perspective, questioning accepted practice and contributing lessons and best practice from other sectors
- can establish itself as a trusted critical friend with the company responsive to its challenge.

Contributing to rebuilding trust

There is arguably a greater need now for effective customer challenge of water companies' behaviour and their delivery of the commitments they make in their business plans. The sector's reputation is at a low, with regular negative media comment. The Times is running a

'Clean It Up' campaign 'to address the country's polluted waterways'¹⁸. Showing themselves to be worthy of customers' trust would be an important part of rebuilding the reputations of the companies and their regulators.

ICGs could play a part in this process starting from their existing role in scrutinising and challenging the quality of the companies' customer engagement and the extent to which customers' needs and preferences have informed the business plans. This could be extended to a role in ensuring the companies deliver on their commitments and explain their decisions clearly. The role could work in a number of ways.

- Performance improvement is fundamental to rebuilding trust, judged, among other things, against what is promised in the PR19 and PR24 business plans. There is evidence in Sections 4 and 5 of this report that ICG scrutiny and constructive challenge of business plans and delivery can contribute to improved proposals and performance. Where an ICG's working relationship with their company is effective, the ICG's close, regular contact with the company's leaders and their teams makes it well suited to a role scrutinising decisions and delivery. If delivery goes off track, the ICG can challenge why this is happening.
- Scrutiny and challenge of customer research and engagement was a core part of the ICGs' role in PR24, but not all ICGs' scrutinised how appropriately the company had responded to the research findings in its PR24 proposals. ICGs are well placed to evaluate the interpretation and triangulation of customer research findings with other relevant factors and provide an informed view on how well the company has responded to customers' needs and preferences.
- Customer behaviour change, particularly reducing water consumption, will be a vital part of a well-functioning water system going forward. Many customers are unaware of this and are less likely to be minded to 'help' a water company that they perceive has let them down. Through scrutiny and constructive challenge, ICGs can play an important role in helping companies understand their customers' attitudes to this and to design effective behaviour change programmes in response.
- Effective communication by the water companies will be essential to rebuilding trust. This includes communication about their business plans, the delivery of those plans and any decisions to diverge from the plan, and their response to unforeseen challenges, particularly those that feature in the public eye. Using ICGs as a test audience for communication strategies and materials can contribute to the development of effective public facing communications.

The evidence from this review shows that if all ICGs are to be empowered to deliver effective customer challenge, this will require more than the current approach of Ofwat merely setting out its expectations in formal guidance¹⁹. However, Ofwat's decision to provide guidance on customer challenge for PR24 planning rather than mandating ICGs did facilitate innovation,

¹⁸ The Times, 'Times Campaign: How Britain's waterways became a dirty joke – and why we should act now' (February 2023)

¹⁹ Ofwat (n 5) pages 8-10

and this has provided useful learnings for this Review (Sections 4 and 5) and informed the development of our proposed framework (Section 6).

4 Strength of the customer challenge arrangements

Adding value

It is clear from the evidence gathered in both phases of the research for this report that the ICGs can and do add value. Phase 2 found that for PR24 business planning, ICGs contributed to improving the quality of the business plans, particularly the quality and use of customer research, proposals for support for customers in vulnerable circumstances and addressing the tension between the need for investment and the challenge of affordability. All the ICG Chairs and company representatives were able to cite instances where the ICG's input had improved the quality of the customer research and engagement or the proposals in the plan, or both.

In the most positive examples, companies found that strong challenge from their ICG plus the steer from the Group regarding focus and investment cases led to the company making a stronger case, for example arguing for enhancement expenditure. Similarly, all ICG Chairs and company representatives whose ICGs had operated throughout the PR19 delivery period cited positive contributions from the ICGs during this time.

Risk of being undermined

The success of the companies' different ICG arrangements has been mixed, however. There was significant variation in the aspects of business planning that were scrutinised by different ICGs, in the level of rigour ICGs were able to apply and in companies' willingness to respond to challenge. The experiences of some ICGs showed a vulnerability to being under-informed, cut out of the process at any stage, and ultimately dissolved, with each of these experiences applying to at least one of the ICGs.

The evidence regarding the current challenge arrangements and their effectiveness is covered in detail in Section 5, but a good illustration of the range of approaches taken by the water companies to their customer challenge arrangements is their responses to Ofwat's guidance on its *'expectations for the standards that should be achieved by companies during business plan development for ... customer challenge on the nature, quality and use of customer engagement evidence'*²⁰.

²⁰ Ofwat (n 5) page 2

This comprised eight aspects:

- Independence
- Board Accountability
- Ongoing
- Informed
- Transparent
- Representative
- Comprehensive
- Timely

Ofwat mandated Customer Challenge Groups for PR14 and PR19 business planning. Following consultation, Ofwat took a different approach for PR24, deciding that *'while there should be minimum standards for independent customer challenge ... there should be flexibility for companies to design their own approaches to meet their own specific needs and ambitions'*²¹.

Ofwat repositioned the 'minimum standards' to become 'expectations for the standards that should be achieved' when it published them in February 2022²². The evidence provided to this review demonstrates that the downgrade from 'minimum standards' to 'expectations' has resulted in some companies constraining the challenge they receive by limiting the independence and remit of their ICGs, and the information available to them.

Some companies applied the 'expectations' rigorously, appreciating the benefits of real challenge from their ICG, but others adopted looser interpretations for one or more of the eight aspects. A few company representatives said they had taken the opportunity to implement a lighter touch approach to scrutiny, while one ICG Chair was shocked to discover at the CCW and ICG Chairs' Challenge Co-ordination Group (COG) meetings that the level of openness and responsiveness to challenge that their ICG took for granted was shared by few others.

Without a mandate, the ICGs operate at the discretion of the company. Even with Ofwat's formal guidance, there is leeway for companies to facilitate or limit the quality and scope of their ICG's scrutiny and challenge. Some ICGs are well resourced, allowed to identify their own priorities for scrutiny and have Terms of Reference that empower them to bring in depth scrutiny and high quality challenge to their companies. Others have been allocated a limited role or resources, or both, and this limited the effectiveness of their challenge.

The situation creates uncertainty which can and, in some cases, has led to ICGs reducing their level of challenge for fear of being scrapped. One ICG was effectively dropped for the later part of the PR24 business planning process after having provided feedback on the draft

²¹ Ofwat (n 7), pages 14-15

²² Ofwat (n 5) page 2

business plan. Another experienced a serious impasse with the company over publication of the ICG's work despite Ofwat's guidance that '*The public sharing of all outputs from the customer challenge is a key requirement of companies, to ensure transparency*'²³. Two others were set up only for the PR24 business planning period despite Ofwat's guidance that '*Customer challenge is ongoing, addressing both development and delivery of business plans*'²⁴.

Several company representatives admitted that their companies had found it difficult to set the remit and appropriate level of resourcing for their ICG without a mandate. This was even with the guidance²⁵ issued by Ofwat in February 2022, which some felt should have come earlier in the process. Some had been unsure what remit to give their ICGs, and others had found it difficult to agree the remit and appropriate ways of working with their ICGs.

Improvement and innovation

A notable success of Ofwat's guidance was the section on Board Accountability. Although there was variation in its application, there is evidence that it has driven real improvement in ICGs' influence:

*'The company board is accountable for having in place a mechanism for, and listening to, customer challenge. Company boards should be able to demonstrate how business plans and wider decision-making take account of matters that are important to customers, including those highlighted through the customer challenge process.'*²⁶

This has acted as a catalyst for greater contact between many ICGs and their respective company boards. Section 5.6 covers how this has resulted in boards developing greater understanding of the ICGs' role and expertise, and how a board can leverage this to strengthen its own scrutiny and challenge of the company's business planning and delivery.

Ofwat's 'guidance not mandate' approach facilitated innovation in how ICGs are constituted and operate, enabling this review to gather evidence regarding the behavioural, governance and operational factors that enhance customer challenge, and those that diminish it. This was the source of the '*Checklist for Effective ICG Challenge*'²⁷ in the Phase 1 report, which is reproduced at Appendix C.

Risk of deterioration in customer challenge arrangements

Ofwat will give its view in the PR24 determinations on how well the companies have demonstrated the strength of their customer challenge arrangements. The evidence from this review suggests that customers are currently exposed to a postcode lottery regarding the quality of customer challenge that their water company receives. It is likely that without

²³ Ibid page 9

²⁴ Ibid page 8

²⁵ Ibid pages 8-10

²⁶ Ibid page 8

²⁷ Indepen for CCW (n 3) page 4

changes to the arrangements for customer challenge the strength of these arrangements, and of the ICGs, will remain mixed.

There is a risk of deterioration among companies less committed to real scrutiny and responding to the resulting challenges. While most companies intend to continue with their Groups, others are minded to wait to hear from Ofwat before deciding whether and how to continue. Two companies have decided not to have ICGs for the PR24 delivery period, taking the view that regulatory oversight is sufficient.

Conclusion

There is an opportunity to take the best of the ICG arrangements and provide a clear remit that will enable ICGs to make a meaningful contribution to addressing the challenges the water sector is facing. The evidence (presented in Section 0) of significant variation in the quality of the current arrangements points towards a need for a mandate for ICGs. Our framework proposal in Section 6 describes how a mandate and core scrutiny remit could be combined with best practice guidance and improved information provision to deliver consistently high quality challenge to all water companies.

Ofwat setting a mandate and core scrutiny remit would not only provide clarity, it would enhance the ICGs' standing with their companies, adding weight to their challenge and recommendations. Companies less committed to customer challenge can currently regard these as 'optional'. However, the proposal is for a framework, not a regulatory straitjacket. It is important that companies and their ICG Chairs retain the freedom to structure the ICG and its membership in a form that is best suited to the circumstances of the company and its customers and the local challenges it faces. This should include the option to add further elements to the ICG's role beyond its core remit.

5 Evidence from the PR24 arrangements for customer challenge

This section is structured by the key questions in CCW's terms of reference for the review.

5.1 Effect of removing the mandate

ToR - Assess companies' responses to the removal of the mandate from Ofwat to have Customer Challenge Groups as part of the price review process. Is the company still clearly committed to receiving and acting upon strong local challenge as part of its business planning process?

ToR - Look for evidence that an ICG is sufficiently empowered to challenge its company in a robust and constructive manner without censure. Consider the effectiveness of this challenge, including the response by companies.

Freedom to innovate

Ofwat's removal of the mandate has driven some innovation. There was evidence in Phase 1²⁸ that the PR19 customer challenge arrangements had been thoughtfully reviewed, and the opportunity taken to work out arrangements that companies felt were better suited to today's circumstances.

This included many companies removing the customer research assurance role that CCGs had at PR19. It was felt by many companies and ICG Chairs not to be appropriate. This was partly because of the particular expertise required, which few, if any, members of an ICG would have, as well as the workload and lengthy reporting involved which could limit the wider contribution of the Group. Companies and ICG Chairs had also noted that Ofwat had made its own assessment of the quality of the customer research for the PR19 business plans and had not relied on assurance from the CCGs'.

ICGs were seen as still having a role in customer engagement. In PR24 business planning, all were involved in scrutinising and challenging their companies' customer engagement programmes, though to varying extents. Only five provided formal assurance to the company board on the customer engagement programme. In two of these cases the companies commissioned assurance from consultancies in addition to the ICGs'. Only three ICGs were the sole source of assurance, and two of the three had to recruit additional expertise to fulfil the role.

²⁸ Indepen for CCW (n 3)

With no requirement to have a challenge group, companies could have made alternative arrangements to demonstrate to Ofwat that customers and their representatives are *'able to challenge the companies' ongoing performance, business plans and long-term delivery strategies'*²⁹. All but one opted for a challenge group. The other company appointed an independent individual.

Having the freedom to set their ICGs' structure and remit enabled companies to address concerns they had about the previous process. Several company representatives said that they had found the PR19 process with the CCGs onerous and disproportionate to the value gained. A particular concern was that preparing materials for the Group's review had become an industry in itself, placing a significant burden on those involved. They had looked for ways to reduce this burden while still providing quality information to the ICG. These are covered in Section 5.5.

As noted above in Section 4, the overall strength of the current challenge arrangements is mixed. Several companies had found it difficult to set the remit and appropriate level of resourcing for their ICG without a mandate, and a few had taken the opportunity to implement a lighter touch approach to scrutiny. Others had appreciated having the freedom to get their ICG's remit right, including considering where the ICG can actually have an influence and what would be a meaningful role. They leaned towards the strategic rather than the ICG being in the detail, for example involving the ICG in substantial challenges such as vulnerability, behaviour change and building trust, and key topics that matter to customer perceptions, such as efficiency, drought and water usage. These companies wanted ICG challenge on their thinking and on their delivery. They also wanted their ICGs to be forward looking. Scrutiny of the customer engagement programme remained important, both its design and how the company is interpreting and using the results.

Value of ICG challenge

All the company representatives interviewed in Phase 2 felt that their ICG had added value either to the company's PR24 plan or the company board's scrutiny of that plan. Several felt that the ICG had added substantial value that led to improvements in the company's approach or proposals, or both. Some companies who originally discontinued their ICGs following the submission of PR19 business plans are now keen to continue their Groups: they experienced the ICG adding value during business planning and can see that it also has value to add in the delivery period. A number of companies who had continued their ICGs after the submission of the PR19 business plans felt they were seeing benefits now, in particular the Groups' ability to hit the ground running with their scrutiny of PR24 planning from the early stages onwards.

Company representatives identified distinct value from ICGs' challenge versus that from other contributors. This stemmed from ICGs getting to see the companies' proposals and

²⁹ Ofwat (n 5) page 8

reasoning in depth, early and over time, while also being well informed about the company and the water sector in general:

- Several said their ICG's challenge felt very tough at times, but was made positively, even with kindness, and that the approach felt collaborative, often coming with suggestions for improvement. They valued this and could see that downgrading the level of challenge would reduce their ICGs' value.
- ICG challenge adds value and gets the company to the right answer more quickly. One interviewee summed this up as the company needing to be grown up regarding the ICG's role, pointing out that the Group is not there either to rubber stamp or to make trouble for trouble's sake. If the ICG is making a point, probably many others would make it too; the company should treat it as an early warning.
- ICGs will ask 'why x?', 'why y?' and point out things that may seem obvious in hindsight, but the company has not seen. This is in contrast to 'normal' stakeholders, who tend not to have time and have not built up the relevant knowledge to make such contributions. In addition, company representatives reported that stakeholders often don't understand customer research and insight.
- ICG challenge is more nuanced than that from customer research, even when customers are informed about the issues at play.
- Interesting distinctions were made between ICG's scrutiny and challenge, and that of regulators. These included the perspective that the ICG wants the business plan to be better whereas the regulator wants to be tough and that the ICG can take a local view while regulators focus on broad long-term aims.

One company representative summed up the situation by saying the ICG asks the questions the company doesn't get from customers as they are not aware and doesn't get from regulators as they are in the detail.

The power imbalance

While many companies had reflected on how their ICG could best add value, it was clear that some arrangements were more successful than others at providing effective scrutiny and challenge that influenced the company. With guidance rather than a mandate in place, ICGs currently operate at the discretion of the company and the company has the power to facilitate or limit the level of scrutiny to which it is exposed. Some companies have realised the value that constructive challenge can bring and the Chairs of these ICGs find their Group is empowered to challenge its company in a robust and constructive manner without limitation. In Phase 1 we identified that *'In the cases where both the ICG Chair and their company counterpart said the ICG's challenge was consistently effective and added significant value ... the company, from its leaders down, actively welcomed challenge and acknowledged that challenge will often feel uncomfortable.'*³⁰

³⁰ Indepen for CCW (n 3) page 3

These ICGs were well resourced in terms of membership, time allocated, and information provided and were also able to drive the selection of areas for scrutiny. Others were allocated a limited role or resources, or both, by their companies, and this limited the effectiveness of their challenge. For example, one Group's remit had been set by the company to avoid it 'having to get things through' the ICG, while another had been set up to provide 'light touch' challenge.

The recommendation from Phase 1 to *'Agree a process for working through disagreements between the ICG and the company, including surfacing at Board level any that reach an impasse'* was the one most often commented on spontaneously by interviewees. Some had acted on it immediately, while others planned to. Conversely, several did not see the need for it as they had either not experienced significant disagreements or had always been able to resolve them. This view ignores the risk that the future may be different from the past.

Evidence from Phase 2 demonstrated how this risk can play out. Should the working relationship with the company run into difficulty ICGs are vulnerable, particularly in the absence of a mandate. In one case, the company stopped engaging with the ICG in May after the ICG had reviewed the draft business plan. In another, the company decided not to publish the ICG's report on its business plan despite previously having published its reports. One Chair said they had held back on some challenges as they were concerned the ICG was vulnerable to being scrapped. Had a formal process for working through disagreements been in place, these difficulties might have been avoided or reduced.

There are signs that not all companies are committed to ongoing independent challenge. Ten of the water companies continued with their Customer Challenge Groups following submission of PR19 business plans. We know of two that will not continue now the PR24 plans have been submitted. While most companies say they plan to continue with their ICGs a minority are awaiting Ofwat's view before deciding.

More effective elements of ICG challenge

In both phases of the research, some ICG Chairs were confident that the ICG was delivering effective challenge - to which the company listens, that influences decisions and that the company finds valuable. Just over half concluded that their challenge of the PR24 plans had been 'very effective', with most of the others thinking it had been 'somewhat effective' and one thinking it had not been very effective.

When asked which aspects of their scrutiny had been most effective for the PR24 business plans, ICG Chairs most often said their influence on the quality of customer engagement and how the companies took customers' views into account. Issues of vulnerability support and affordability in the face of investment need were also mentioned by some. A few Chairs emphasised that being able to scrutinise and challenge from the early stages of business planning enabled the ICG to influence their company's level of ambition. Company representatives broadly agreed with the ICG Chairs' analysis of where the ICGs had been most effective.

Less effective elements of ICG challenge

When asked about aspects of the ICG's scrutiny that could have been more effective, the ICG Chairs' most common concerns were lack of time for scrutiny, either because materials, including drafts of the business plan, were not provided early enough, or because turnaround times were short.

There were concerns about challenges not being addressed in a timely way. More experienced ICG Chairs were aware that time being short is a common issue in the run up to submission of business plans, but there was a feeling among both ICG Chairs and company representatives that the ICG's involvement in the PR24 process had been particularly tight on time.

There were additional concerns from a small minority of company representatives who had not found their ICG's input as useful as they had hoped. These were

- input limited to criticism and unwillingness to offer any input on solutions
- unwillingness to express a view about whether the company had responded to research findings appropriately
- ICG and company being at odds over the ICG's role during the scrutiny process, with the ICG wanting a wider role reviewing more aspects of the business plan

These issues point to problems with communication between the ICG and the company and a failure to establish mutual trust and agreement. Evidence in both phases of our research showed that many companies and ICG Chairs see building a relationship of trust between the ICG and the company as fundamental to success. Where trust has been established and the ICG is seen as a 'critical friend', with equal emphasis on 'friend' and 'critical', the ICG Chairs had generally found that their companies were responsive to the Group's challenge, and that company representatives had valued the challenge from the ICG. This does not mean that the relationship is cosy. In both phases of the research, most of the companies who had found their ICG's challenge particularly useful also described it as being uncomfortable at times. The process works because there is trust that both the ICG and the company are aiming to improve delivery for customers, and the ICG presents its challenges constructively.

It was clear that the companies want input from their ICGs as well as challenge, though they are not expecting ICGs to provide 'the answer' along with their challenge. They appreciated suggestions for improving their approach (e.g. to research or the proposals in the plan) and for improving the narrative and explanations in the business plan. Some found that their ICG's input made a meaningful difference to how quickly the company got to the final plan.

Getting the balance right is important. Just as it is possible for an ICG to undermine its own effectiveness by insisting on providing only challenge, ICGs are vulnerable to being steered towards the 'friend' aspect of providing ideas and input, and away from meaningful scrutiny

and challenge. This can take the form of limiting the information to which they have access and the time available for scrutiny.

Ofwat guidance

Many company representatives expressed a desire for clarity in future from Ofwat on the role of the ICG. Some had been frustrated by Ofwat not mandating ICGs but then issuing guidance on customer challenge, which they felt was an unhelpful halfway house. Others pointed out that both companies and ICGs would benefit when the remit was clear and that boundaries are useful and help avoid duplication of roles.

There were many requests for Ofwat to provide clarity about the ICGs' role early. This enables companies and ICG Chairs to ensure the membership has the appropriate range of expertise and maximises the opportunity for ICGs to influence their companies. At Phase 1 where ICGs had started their PR24 scrutiny within 15 months of the business plan submission deadline, the ICG Chairs were more likely to think that this had been too late. The concerns centred on feeling that by this point the ICG had lost the opportunity to influence the company's thinking. The ICG's role became more limited, reacting to the company's thinking in more of a 'show and tell' process. In contrast, ICGs that continued to scrutinise their companies during PR19 delivery were more likely to feel that their PR24 scrutiny started at the right time.³¹

Conclusion

Ofwat's removal of the mandate has enabled companies who value customer challenge to innovate and to refine their approach to maximise the value of their ICGs. Where arrangements are in place to facilitate high quality scrutiny and challenge, ICGs' distinctive input can and does add significant value for companies and customers. Unfortunately, the current arrangements enable companies that want to limit scrutiny to do so.

Ofwat should provide clarity about the ICGs' role as early as possible in order to enable companies and their ICG Chairs to make arrangements that will maximise the effectiveness of the ICGs' challenge during PR24 delivery and going forward.

5.2 Independence of the ICGs

ToR - Assess the degree to which the ICGs operate independently of their company's interests, including how well they are able to demonstrate this independence. How were members appointed, was this independently of the company?

Risks to independence

As noted in our Phase 1 report, *'There are some obvious tensions here. The water company pays for the ICG and the ICG relies on information provided by the company. Independence cannot be*

³¹ Indepen for CCW, (n 3) page 38

*guaranteed by the structure of the group or its processes but comes down to attitudes and behaviours. There must be a genuine commitment to independence by every member of the ICG and everyone dealing with the group on the company side; without this the ICG's independence is at risk.'*³² The evidence gathered in Phase 1 suggested a set of structural and behavioural approaches that facilitate independence. These relate to governance, recruitment, the role of the company's leaders, and the value of contextual information about the Water sector and comparative information about company performance.³³

As noted in Section 4, without a mandate the ICGs operate at the discretion of the company and there is leeway for companies to limit the ICG's scrutiny. In the absence of a mandate, it is also possible to undermine the ICG's independence.

An independent chair

All but one ICG has an independent chair. Without one there is a risk to perceived and actual independence as their independent oversight of key processes is absent. For example, their involvement in member recruitment and agreement of Terms of Reference, oversight of members' approach to scrutiny and reporting of the ICG's scrutiny and challenge publicly and to the company board. At Phase 1, many company representatives emphasised how important having the right Chair is to the quality of the ICG's contribution and independence.

Term limits and recruitment

Most contributors agreed with the Phase 1 recommendation of a term limit for ICG Chairs and members, including the option to consider circumstances in which exceptions could be made, for example to keep expertise in the group. Two price control terms was the preferred limit as it was felt to strike a balance between the gains from developing expertise while limiting the risk of 'capture' by the company. A few contributors queried whether imposing any term limit was relevant as they valued the contributions of long serving members. Others had observed disproportionate focus or 'hobby horsing' on certain topics from some long-standing members as well as a few wanting to maintain CCG roles from previous price controls.

The Phase 1 recommendation of considering open recruitment for some or all roles on the ICG was received positively by ICG Chairs and company representatives. While the majority already have it in place, several of those who have not yet implemented it plan to do so.

Conclusion

A set of structural and behavioural approaches that facilitate independence were identified at Phase 1, and Phase 2 indicated that they had been well received, including greater use of open recruitment. They would be a good basis for the development of best practice guidance on achieving and maintaining ICG independence.

³² Indepen for CCW, (n 3) page 12

³³ Indepen for CCW, (n 3) pages 12-17

The current arrangements enable companies that want to limit scrutiny to do so and the related risk of companies undermining their ICG's independence will continue while they are in place. Ofwat could emphasise the importance of having an independent ICG Chair by interviewing each Chair before appointment. This would be similar to the process it has adopted for the appointment of independent non-executive directors to the boards of the water companies.

5.3 Constitution, role clarity and capacity

ToR - Consider whether the ICGs are formally constituted with clear purpose, function and governance detailed in a Terms of Reference that has been agreed with both the Executive and Board of the Company.

ToR - Determine how clear the remit of each ICG is and the extent to which the local challenge arrangements are set up to enable the groups to fulfil their stated functions. This will include reviewing the capacity of the ICG to deliver its workload.

Terms of Reference

With challenge groups no longer mandatory, Terms of Reference have greater importance in setting out the purpose of the ICG, the ways of working that will facilitate effective delivery, and the part the company will play in enabling this. Phase 1 revealed a mixed picture. All but one ICG had agreed or were updating Terms of Reference, but the content and emphasis varied. We examined whether each ToR included five elements that are important in enabling the ICG to provide effective challenge to the company. Most had none of them and no ToR included all five:³⁴

- A common, outcome-focused objective for both company and ICG: 5 out of 15
- A high-level view of what constitutes effective delivery (i.e. how the ICG is expected to perform its role): 6 out of 15
- Mention of the company board authorising the ICG to carry out its duties: 2 out of 15
- Mention of the ICG having the option to escalate issues to the board: 1 out of 15
- Mention of the ICG providing 'constructive challenge' or acting as a 'critical friend': 7 out of 15 (one ToR includes both terms)

By Phase 2, several ICGs and their companies had reviewed and updated their ToRs following the Phase 1 recommendations³⁵, and others said they planned to do so.

The run up to the submission of the PR24 business plans highlighted the importance of clear Terms of Reference, including for any subgroups, with many ICG Chairs and company representatives stressing their importance in the Phase 2 interviews. One ICG Chair who had

³⁴ Indepen for CCW (n 3) page 23-24

³⁵ Indepen for CCW (n 3) page 27

initially struggled to get traction with their company had found that they could increase the level of challenge they provided by evolving the ToRs using the recommendations from Phase 1. Interviewees from the situations where the working relationship between company and ICG ran into trouble identified gaps in the ToRs.

ICG sizes and structures

The size of ICGs varied, ranging from 1 to 11 members at Phase 2, excluding CCW and EA representatives. Almost half had around 6 (5-7) members. Some had subgroups, others had decided not to for reasons including wanting to reach overall ICG views. Several company representatives endorsed the value of ICGs coming to an agreed view, for example saying how useful it had been to have both environment and customer perspectives on the Group, including experts on supporting vulnerable customers. In particular they had appreciated their Groups' work to come to a unified ICG position on the appropriate balance between investment in the system and affordability, including challenge on the phasing of price increases and programmes to support those who would struggle to afford higher bills.

Three companies had separate environment scrutiny groups. In two of these, the Chairs of the ICG and environment group were members of the other's group or attended some of its meetings, thus ensuring each was informed about the other's work and perspectives.

Smaller Groups found ways to maximise their value. Several companies with smaller ICGs said that in addition to formal ICG meetings, they had found benefits in calls with individual members about aspects of the PR24 plans related to their particular areas of expertise. Some ICGs got input from groups or organisations at relevant points, without them being members of the ICG. The CCW representatives observed in their focus group that smaller ICGs could work well, sometimes resulting in increased focus.

Several Phase 2 interviewees suggested that delivering an ICG's responsibilities is a very demanding task for one person. This effectively occurred in more than one case because as well as the company where a single expert was recruited to provide customer challenge, there were cases where members made limited or no contributions, resulting in the ICG Chair taking on almost all the work.

Conclusion

Clear, well constituted Terms of Reference are an essential part of a well-functioning relationship between a company and its ICG. Gaps pose a risk to effectiveness should the working relationship run into difficulties. It is positive, therefore, to see that the important gaps in all ICGs' ToRs identified in Phase 1 are being addressed.

The size of an ICG does not equate to its effectiveness, and there has been positive innovation enabling smaller ICGs to work effectively. However, the evidence indicates that expecting a single 'independent challenger' to perform a full ICG role is too great an expectation. Rather than conforming to a prescribed size, each ICG should be constituted to be able to provide relevant challenge that considers the circumstances of the company's area and customers.

5.4 Membership and expertise

ToR - Consider the level of expertise among the Chairs and members of each ICG. This will be linked to the stated remit of the groups - is the ICG adequately resourced, in terms of the skillset among its members, to undertake the tasks it is anticipating?

ToR - Are ICG's members experts in a particular field or stakeholder representatives representing a particular organisation?

ToR - To what extent do CCW, Environment Agency, Natural Resources Wales and DWI contribute to the ICG?

The right mix of expertise

The ICG's role is an unusual one, and establishing a Group with the right mix of expertise to deliver effective challenge is not straightforward. There are considerable variations between water companies which preclude a one size fits all approach. Instead, each ICG should be constituted to be able to provide relevant challenge given the make-up of the company's area, geographically and in terms of its communities. Phase 2 interviewees had found that this had largely been successful, but some risks identified in Phase 1 caused problems during the scrutiny of the PR24 plans.

Phase 1 had revealed that the ICG Chairs are generally highly valued by their companies. A similar picture emerged in Phase 2, with appreciation by many companies and ICG Chairs of high quality, expert scrutiny and challenge which some described as Board level quality.

Phase 2 examined the ICGs' scrutiny of PR24 business planning and found that most ICG Chairs thought they had an appropriate range of expertise on their ICG for this. Both company representatives and ICG Chairs said that the contributions of ICG members with high levels of expertise in their specialist areas were particularly likely to be influential.

Companies and ICG Chairs whose ICG had members or advisers with expertise in the water sector found this invaluable. The same applied to having a good, independent secretariat ('secretariats' provided by the company tended to struggle to provide support), and report writer – sometimes same person. Secretariats with expertise in the sector were particularly appreciated.

Underperformance challenges

Not all ICGs had uniformly positive experiences. In several Groups some or even all members contributed little to the challenge process in the run up to the submission of PR24 plans, including not attending meetings. This was more likely to happen on ICGs where independent members were unpaid.

Some groups had particular problems with the performance of certain members, who focused only on their own interests. Some company representatives said in Phase 2 that they were considering adding more customers to their ICGs from particular customer groups. It is

important that the interests of subgroups across the customer base are taken into account by the ICG, but evidence from both phases of this review suggests that unless members can consider the interests of customer groups beyond their own, as well as the customer base as a whole, direct representation can backfire. It is also difficult in practice for one individual to represent the whole of a customer subgroup.

A similar risk applies to members representing particular stakeholder groups, with reports at Phase 2 of some simply not contributing to scrutiny on topics beyond those directly affecting their stakeholder group. Another side to this risk was illustrated by a few reports of members from campaigning groups seeking to dominate ICG discussions, focusing only on pursuing their own objectives.

These risks can be managed by ensuring that the recruitment process covers potential members' ability to take into account the interests of different customer and stakeholder groups as well as the customers as a whole.

The importance of building sector knowledge

The induction process for ICG members is important. Ofwat's guidance emphasises that *'It is of primary importance that the mechanism for customer challenge is truly independent of the company'*³⁶ and many ICG members bring a valuable external perspective, questioning accepted practice and contributing learnings and best practice from other sectors. This needs to be combined with a good understanding of the water sector if the ICG is to provide incisive challenge consistently. As noted above, those ICGs who had members or advisers with expertise in water found this invaluable. Even in Groups with access to such expertise, all members need to develop a good baseline understanding of the sector if they are to be able to challenge effectively. This must be taken seriously, starting with the induction process.

At Phase 1, both ICG Chairs and company representatives observed that ICGs who had gained knowledge over time were adding significant value. Conversely, some ICG Chairs, particularly of newer ICGs formed for the PR24 planning period, found that members struggled to get up to speed. Phase 2 found that this had further impacts in the later stages of business planning. This was generally a smoother process for those ICGs that had operated continuously since the submission of the PR19 plans. Members were up to speed on the water sector and the ICG had established its role. Newer ICGs still contributed but were more likely to have members who struggled to get to grips with the sector, in some cases dropping out because of this, which impacted the ICG's work.

Uneven contributions from the regulatory and statutory bodies

The evidence from Phase 2 showed that CCW, the Environment Agency (EA), Natural Resources Wales (NRW), Natural England and the DWI made uneven contributions across ICGs in the run up to the submission of the PR24 business plans. CCW is represented on all

³⁶ Ofwat (n 5) page 8

ICGs and EA/NRW provided input to most Groups, but ICG Chairs and company representatives reported that the contribution varied across representatives, including being poor in some cases with low attendance at ICG meetings and little input. There were also several cases where the representative changed – sometimes more than once. Natural England provided input to fewer than a third of ICGs, and DWI to only 3.

When knowledgeable representatives are present, the contributions of these bodies are valued because they have greater sector knowledge than many ICG members. They can provide the groups with technical, specialist information in the form of independent research, data and views, including raising concerns. They also help the ICGs understand regulatory programmes and requirements.

Much of the variation in attendance and the quality of input from these bodies was attributed to lack of resources. Where the contributions were high quality, they were valued by both ICG Chairs and company representatives, improving the quality of the ICG's scrutiny and challenge. It is important that all ICGs have access to the expertise of these bodies, including being informed of concerns and priorities that are relevant to the ICG's scrutiny. With resourcing each ICG individually proving impractical, priority could be given to providing such information centrally.

A related aspect of empowering ICGs through information is access to comparative data about company performance. The companies have discretion as to what they provide, and there is inevitably variation in what ICGs are shown. Instead, consistent comparative information could be provided by Ofwat and the other regulatory and statutory bodies via the COG meetings. CCW have successfully trialled this with information covering companies' financial performance, customer satisfaction and preferences, and complaints which most ICG Chairs found useful.

Conclusion

The right mix of expertise for an ICG will depend on the make-up of the water company's area, geographically and in terms of its communities. It is essential that members are able to scrutinise beyond their own interests and that they understand the importance of doing so.

Access to technical expertise in water is important for an ICG, as is a suitable induction process and ongoing education about the sector. All ICG members need a good baseline understanding of the water sector if they are to be able to challenge their company effectively.

The regulatory and statutory bodies may have insufficient resources to provide a consistent level of input to each ICG individually. If this cannot be resolved, priority should be given to finding a way to provide data and expertise to the ICGs centrally. The COG has already proved to be a suitable forum. It has the advantage over simply circulating information of providing the opportunity for discussion with and between the ICG Chairs. This would address the concerns expressed by some company interviewees in Phase 1 that the company cannot be fully open with its ICG when there is a regulator in the room. If there is a need for

follow-up regarding a particular company's performance, this could be arranged on an ad hoc basis.

The COG has proved to be a forum that enables the ICG Chairs to share best practice and learning from overcoming new challenges, enhancing the overall expertise and effectiveness of the ICGs in delivering influential customer challenge.

5.5 Resourcing and remuneration

ToR - Consider how transparent the company is in sharing information with the ICG.

ToR - Is the information provided to the ICG by the company in relation to its activities and business planning shared in a timely manner and with adequate context in relation to company performance (both historically and in relation to the rest of the sector)?

ToR - Consider whether the ICG is sufficiently resourced to carry out its stated functions.

Provision of information to the ICG

Phase 2 found that most ICG Chairs felt they got all the information needed from their company to carry out their role in scrutinising PR24 business planning. Almost all felt they had had sufficient access to members of the management team and to technical experts within the company. One ICG had moved to limiting the volume of information the company provided so the Group was not swamped.

Unfortunately, a positive experience was not universal. Around a third of the Chairs found that there were some areas where the company did not provide all the information the ICG needed in order to perform their role. For some of these Groups this was because of unresolved disagreements with the company about what the ICG should be scrutinising. In one case the information shortfalls seriously compromised the ICG's ability to perform the role it had agreed with the company board.

Concerns were raised in Phase 2 about the timeliness of information from the companies. Only one ICG received all the information on time, though the majority received it on time 'most of the time'. A third said it was on time 'some of the time'. Most ICG Chairs appreciated that companies were under time pressure themselves, particularly towards the end of the process. However, a few Chairs questioned whether their companies deliberately manipulated the timing or content of what was shared in order to limit scrutiny from the ICG, for example requiring a very short turnaround or providing the information piecemeal so it was harder to understand the overall picture. Given the demands of the business planning process, it is not surprising that many company representatives stressed their appreciation of the flexibility and responsiveness shown by both their ICGs and individual members, while others stressed the damage a lack of flexibility had, in their opinion, caused to the quality of the ICG's input and the working relationship with the company.

Most company interviewees had found the process of providing information to the ICG manageable. Some admitted that they had struggled with the timing. As in Phase 1, a small minority voiced concerns about producing information for the ICG ‘becoming an industry’, but these seemed to be centred on avoiding a repeat of the PR19 experience. In response, they had looked for ways to reduce the burden on their teams. Some had reduced the amount of information they were sharing with the ICG through narrowing the role of the Group, for example not providing formal assurance of the customer research. Several had made greater use of existing materials such as board papers, signposting relevant sections.

In one case the company had wanted to evolve the ICG meetings to be more like company board meetings, discursive and challenging with less emphasis on the technical side. The company teams still did pre-work, but this was specifically designed to lead to the richer discussions the company succeeded in having with the ICG, resulting in teams seeing the benefit of their preparatory work.

Improving ways of working

In general, the companies who said they had gained most value from their ICGs were clear that if you want the greatest value from your ICG, you have to put the time in. This included evolving the way they were working with their ICGs to meet today’s circumstances. For example, several companies with smaller ICGs said that in addition to formal ICG meetings, they had found benefits in calls with individual members about aspects of the PR24 plans related to their specific areas of expertise. This provided many of the benefits of a subgroup approach, but with the greater flexibility relevant for smaller ICGs. Another company representative is planning alternatives to their current approach of three hour ICG meetings, which they hope will enable participation by a greater diversity of members. One continues their established principle of transparency, including sharing regulatory letters and the ICG Chair participating in, rather than observing, the whole Board meeting when they attend.

ICG Chairs understood that the run up to the submission of a business plan is a challenging time. Evidence from the Phase 2 interviews suggested that the more established ICGs managed better, including working successfully with the company to adapt the process so the workload was manageable. Recently formed Groups were more likely to have members who dropped out or didn’t contribute as expected.

Subjects scrutinised

At Phase 1, all ICGs expected to scrutinise their companies’ customer engagement, and almost all expected to cover affordability, community engagement, stakeholder engagement, environmental improvements and resilience³⁷. In their interviews, some added that their scrutiny would be influenced by the findings of research and engagement programmes regarding customer and stakeholder concerns. It was clear from the interviews that the

³⁷ Indepen for CCW (n 3) page 37-38

concerns of affordability and environment, and the trade-offs that will need to be made for PR24, were front of mind for both ICGs and water companies.

The interviews for Phase 2 confirmed these findings, with emphasis on the ICGs' contributions on the quality and use of customer research, support for customers in vulnerable circumstances and addressing the tension between the need for investment and the challenge of affordability.

ICG scrutiny also covered other topics. In response to a prompted list of 30 items in the Phase 1 questionnaire, the ICG Chairs said that their ICGs would be covering an average of 23 topics in their PR24 scrutiny. Phase 2 found that most ICGs reviewed fewer topics than anticipated. One outlier reviewed 24 fewer topics than expected. Ten ICGs reviewed six fewer topics on average. Five ICGs reviewed 2 or 3 more topics than expected at Phase 1. The full list of subjects expected to be scrutinised and actually scrutinised is in Appendix D.

Reviewing draft and final business plans

Not all companies shared a draft or final PR24 business plan with their ICG. 11 out of 16 ICGs reviewed the draft BP and another three reviewed a summary or selection of proposals with one more seeing it 'for information'. One ICG did not see it in any form. Some scrutinised the narrative as well as proposals, others just the proposals.

Half the ICGs saw the final BP for review and a further three saw it 'for information'. There were different views on how much of the business plan the ICG needed to see, but a substantial majority of interviewees agreed that there is value in the ICG scrutinising a draft of the plan.

Reviewing the final business plan would come too late to influence the plan but a majority agreed that the ICG would need to review the final proposals if it was to make a final report to the company board and be able to publish a report of its scrutiny and challenge in which customers could have confidence.

Ability to complete the scrutiny

Overall, at Phase 2, almost all ICG Chairs said they were able to complete the scrutiny of business planning that was merited. Two said they had been unable to do so.

Remuneration

In Phase 1, most contributors agreed that remuneration is necessary and makes it possible to hold ICG members to account for the quality of their work. Without claiming direct substitutability, some company representatives had found that the quality of their ICG's input had enabled the company to avoid consultancy that it would otherwise have commissioned.

Risks identified from not paying members included: members focusing on topics they personally cared about; being influenced by the agendas of the organisations who pay them;

deprioritising their ICG work in favour of paid work; and making it more difficult to recruit members of the appropriate calibre and with relevant expertise.

A small number of company representatives disagreed with paying ICG members apart from the Chair. Reasons for this included the unsubstantiated view that customers would not think paying for an ICG was good value and concerns about affordability. Two interviewees said that if ICG members are paid by the water company they would be less independent, and this view was echoed by one contributor at Phase 2.

There are risks to the quality of contribution if ICG members are not paid. The ICGs for companies that did not pay had more problems getting member input. Some are now considering paying members in the future. Companies who had recruited and paid for 'board level' expert challenge were more likely to appreciate the input from their ICG and to say that the Group made a significant contribution to the quality of their PR24 plan.

The cost of funding an ICG is a legitimate concern, particularly for the smaller water companies. The evidence for this review is that small ICGs can work well (Section 5.3), and that ways of working more efficiently had been found. The possibility, noted above, of avoiding or reducing consultancy spend if an ICG's input is high quality is also relevant.

At Phase 2, several ICG Chairs reported that they had needed to spend much more time on scrutiny of PR24 planning than had been planned and in some cases the extra time was not remunerated. Some saw this as a fact of life. Others thought the company should have managed the process better and remunerated them for the additional work they did.

Conclusion

The inevitable reliance of ICGs on their companies for information about company performance and decision making and access to draft and 'near final' business plans presents a risk to the quality of the scrutiny and challenge. There is evidence that some companies used the timing and content of the information provided to reduce the ICG's scrutiny.

Companies who worked in partnership with their ICGs on the areas where ICG scrutiny was relevant were more likely to say the ICG had added value as were companies who had recruited and paid 'board level' expert members. If members are not paid there are risks to the quality of the ICG's scrutiny.

5.6 Board Access

ToR - Consider the visibility of and importance given to the work of the ICG by the company Board. Does the ICG have unmediated access to the company Board, with regular attendance by company Board members at ICG meetings and vice-versa?

ToR - Is there a clear process outlining how the work of the ICG will influence the Board's sign-off of the business plan and long-term strategy?

Ofwat was clear that it regarded company boards as accountable for effective customer challenge at PR24:

*'The company board is accountable for having in place a mechanism for, and listening to, customer challenge. Company boards should be able to demonstrate how business plans and wider decision-making take account of matters that are important to customers, including those highlighted through the customer challenge process.'*³⁸

Evidence from the Phase 2 interviews suggests that this was achieved and that there had been an improvement in ICGs' relationships with company boards. Meaningful contact with the boards in the run up to the submission of the business plans had increased.

At Phase 1, while more than three-quarters of ICG Chairs said they attended a Board meeting at least once a year to provide an update on the ICG's work, only two ICGs had a formal process agreed with their company setting out how the work of the ICG would interact with the board's sign-off of the PR24 business plan. In Phase 2 this had increased to 13 out of the 16.

We understood that there was a sense among ICG Chairs that boards that previously had had limited contact with their ICG were more appreciative of the contribution of the ICG, particularly the scrutiny of the quality of the customer engagement programme and of the company's responses to findings about customer needs and priorities. Several ICG chairs said that their contact with the company board had strengthened the ICG's influence, with the board, for example, asking the ICG for its views on whether the company was doing enough to respond to customer views and challenging the Management Team about its response to ICG challenges. In several cases new conversations have begun about how the board can use the ICG and two Chairs have challenged their company board about how the board itself thinks about customer needs. Many company representatives said that the board had valued the contribution of the ICG. This included one who had been sceptical about the potential.

Most ICGs have independent non-executive director (INED) observers or 'sponsors' at one or more of their meetings each year. While observers may feed back to the board about the meetings, 'sponsors' took a more active role, talking to the ICG Chair between meetings, and using ICG material to challenge the company. With company boards accountable for customer challenge, the 'sponsor' role may be more appropriate than a passive observer role.

Conclusion

Ofwat's decision to make company boards accountable for customer challenge at PR24 has made a difference. It has driven an increase in meaningful contact between boards and ICGs, and more appreciation of the contribution an ICG can make to the company and to the board's scrutiny of the company.

³⁸ Ofwat (n 5) page 8

5.7 Visibility of the ICG's work

ToR - Consider how transparent and visible the ICG's work is to interested stakeholders. Are details of the work of the ICG easily available? Are agendas, minutes and a record of both challenges and company responses to these challenges published on a dedicated ICG website/page? Is this information updated regularly and in a timely manner?

Visibility of the ICGs

Phase 1 found that the ICG Chairs generally thought that publishing information about the ICG's work was important. Many saw this as being about transparency, holding themselves and the company to account for delivering effective challenge and responding to this challenge appropriately. However, Phase 1 also revealed a mixed picture regarding the transparency and visibility of the different ICGs' work online³⁹.

There is considerable variation in what is published and how accessible it is. Phase 1 found that only half of the ICGs published regular reports about their work, and some ICGs and companies appeared to have thought harder than others about what visitors might want to know. They provided clear, accessible summaries of the ICG's purpose and work, rather than solely in downloadable documents, and had gone out of their way to provide content in consumer-friendly language. A few ICG Chairs reported problems with getting timely publication of ICG materials by the company.

Phase 2 found that all but three ICGs wrote a report giving their view on the company's PR24 business planning. These included challenge and response logs, and all but one were published. Of the three ICGs that did not write such reports, one provided an assurance report on the company's customer and stakeholder research and engagement. One provided a short statement within the company's business plan submission. One did not report at all.

For many ICG Chairs the challenge and response logs had formed the basis of their reports. They were also mentioned as important by many company representatives, who said a log sets the discipline of getting each challenge to a conclusion, whether or not the company accepts the challenge. One noted that it also demonstrates the achievements of the ICG.

Conclusion

Public records of the ICG's scrutiny and challenge, and the company's response, are important. They hold both the ICG and the company to account for the quality of customer challenge and the response to that challenge. The focus should be on accessible presentation, efficient ways of working and timely publication rather than 'chapter and verse' of every meeting. Annual well written summary reports, presented together with a challenge and response log, can make the ICG's work accessible to interested customers and stakeholders whether they are sector experts or entirely new to the issues.

³⁹ Indepen (n 3) page 46-47

6 Recommendations: a proposed framework for ICGs

Our proposed framework is intended to enable consistently high quality ICG challenge to all water companies. It acknowledges the causes of ineffective ICG challenge as revealed in our research. It addresses the power and information imbalances that currently limit the effectiveness of many ICGs and risk undermining all of them. It also agrees with Ofwat on the importance of *'flexibility for companies to design their own approaches'*⁴⁰ for effective challenge tailored to the circumstances of the company's area and customers and recognises the role that best practice guidance can play in that.

The framework has four elements:

- Governance: four mandatory essential elements
- Scrutiny remit: a core remit for each price control – business planning and delivery
- The Guidance: evidence-based best practice for effective challenge
- Information: consistent regulatory information, and shared learning

Ofwat setting a mandate and core scrutiny remit would enhance the ICGs' standing with their companies, adding weight to their challenge and recommendations. Companies less committed to customer challenge can currently regard these as 'optional'.

6.1 Governance

Ofwat's *'expectations for the standards that should be achieved'*⁴¹ cover essential elements of effective customer challenge:

- Independence
- Board Accountability
- Ongoing
- Informed
- Transparent
- Representative
- Comprehensive
- Timely

⁴⁰ Ofwat (n 7) page 14

⁴¹ Ofwat (n 5)

Ofwat set 'expectations' rather than the 'minimum standards' it originally planned. The evidence in this review demonstrates that some companies have used this to limit the challenge they receive from their ICGs.

At the same time, there is evidence that Ofwat's decision to provide '*flexibility for companies to design their own approaches to meet their own specific needs and ambitions*'⁴² has enabled innovation in ICG structures, membership and remits. Given the variation between water companies across numerous dimensions including size (customer numbers, lengths of main), geography and environment, water sources, population distribution, demographics and asset age, it is essential that companies have the freedom to design their own approaches to customer challenge, including ICGs.

Our proposal, therefore, is that Ofwat establishes a limited mandate for ICGs that sets minimum standards in four areas where Ofwat has set expectations, but the evidence has shown ICG effectiveness is particularly vulnerable to being undermined: Independence, Board Accountability, Ongoing and Transparent

Such a mandate should result in an improved baseline level of ICG scrutiny and challenge without companies losing the freedom to design customer challenge arrangements that best fit the particular circumstances of the company's area and customers in line with Ofwat's original intention.

The proposed minimum standards are:

Independence

- Require each ICG to have an independent chair who has no links to the company and is appointed through an open recruitment process
 - At Phase 1, a majority of company representatives emphasised unprompted how crucial the ICG Chair was to the group operating in a way that was genuinely independent⁴³. However, the preparations for PR24 have shown that left with the choice, not every company will appoint an independent chair.
 - Ofwat could emphasise the importance of having an independent ICG Chair by interviewing each Chair before appointment. This would be similar to the process it has adopted for the appointment of independent non-executive directors to the boards of the water companies.

Board Accountability

- Make the company board accountable for enabling, and listening to, the ICG's challenge

⁴² Ofwat (n 7) pages 14-15

⁴³ Indepen for CCW (n 3) page 14

- The evidence suggests Ofwat introducing the ‘expectation’ that *‘The company board is accountable for having in place a mechanism for, and listening to, customer challenge’*⁴⁴ has driven a positive change in many ICGs’ relationships with their companies’ boards. This is not the case for all ICGs, however. Some ICG Chairs do not attend a Board meeting at least annually, and some did not have an agreed process for how the work of the ICG would interact with the board’s sign-off of the PR24 business plan.

Ongoing

- Require ICGs to be ongoing, scrutinising both business planning and delivery
 - Despite Ofwat’s ‘expectation that *‘Customer challenge is ongoing, addressing both development and delivery of business plans’*⁴⁵ two ICGs were set up only for the PR24 business planning period, and while most companies say they plan to continue with their ICGs a minority are awaiting Ofwat’s view before deciding whether to proceed.

Transparent

- Require companies to publish annual reports from the ICG summarising their scrutiny and challenge to the company over the previous year and including a challenge and response log
 - Phase 1 found that only half of the ICGs publish regular reports about their work. Phase 2 revealed that not all ICGs wrote a report giving their view on the company's PR24 business planning, and that not all of those that were written were published.
 - In line with Ofwat’s request the ICGs’ reports on their PR24 scrutiny and challenge, these reports should be sent to Ofwat

6.2 Scrutiny remit

The mandated core scrutiny remit should be focused on enabling ICGs to help the companies, regulators and statutory bodies meet the challenges the sector is facing. They could play a complementary role by following up on regulatory scrutiny and reporting, thus enhancing the impact of the regulatory and statutory bodies. The remit should be updated as circumstances evolve.

With the sector current facing the considerable challenge of rebuilding public trust, and also reducing water consumption, the core remit could initially focus on scrutinising and challenging:

- the design and delivery of business plan commitments, including
 - a draft business plan provided at least six months ahead of the submission date

⁴⁴ Ofwat (n 5) page 8

⁴⁵ Ibid page 9

- performance and other commitments made in the business plan
- any change of circumstance the company finds is limiting its ability to deliver
- the design of the company’s customer engagement programme, in particular examining whether all relevant customer groups are included and whether participants are provided with sufficient context and appropriate questions to enable meaningful responses
- the company’s responses to the findings from customer engagement, including their triangulation with other relevant factors
- company explanations of how they plan to respond to important customer concerns, including ones with a high public profile, and of why they have decided to take these particular actions
- the design and scope of the company’s customer behaviour change programmes

6.3 Guidance

As previously discussed, it is important that companies and their ICG Chairs retain the freedom to structure the ICG and its membership in a form that is best suited to the particular circumstances of the company’s area and customers. This includes the option to add further elements to the ICG’s role beyond its core remit.

It is also important that companies and ICG Chairs make such decisions informed by knowledge of what facilitates effective challenge, and what risks undermining it. The evidence across both phases of this review has provided important learning regarding the structural, governance and behavioural factors that together facilitate effective scrutiny and challenge. As noted in our Phase 1 report, providing robust challenge is not difficult. Providing effective challenge to which the company listens and that influences decisions is far more demanding.

Best practice guidance that draws on the learning from this review and other sources will be invaluable to companies and their ICG Chairs, particularly newly appointed ones. Their number is likely to increase soon, with several Chairs preparing to stand down having served across two price control periods.

The organisation that seems best placed to develop such guidance is CCW. Alongside the learnings from this review, which CCW commissioned, they have considerable direct experience of ICGs and their CCG predecessors and reviewed their operation at both PR19⁴⁶ and PR14⁴⁷.

⁴⁶ Consumer Council for Water, Lessons Learned from the 2019 Price Review (October 2020)

⁴⁷ Consumer Council for Water, Customer Challenge Group process: Review of lessons learned (June 2014)

Areas that Best Practice Guidance for ICGs could usefully cover include:

- Behaviours and practices that enable an ICG to maintain its independence
- Recruitment, remuneration and term limits
- Achieving the right mix of expertise
- Building a ‘critical friend’ relationship with the company
- Achieving and maintaining effective challenge, including resolving disagreements with the company
- Drawing up appropriate Terms of Reference
- The ICG’s relationship with the company board
- Reporting and the visibility of the ICG’s work

6.4 Information

ICGs are currently heavily reliant on their companies for the information on which they will base their scrutiny and challenge. There is some input from the regulatory and statutory bodies of CCW, the Environment Agency/Natural Resources Wales, Natural England and the Drinking Water Inspectorate, but this varies widely across the ICGs. The reliance of ICGs on their companies for information about company performance and decision making presents a risk to the quality of the scrutiny and challenge. This review found evidence that some companies used the timing and content of the information provided to limit their ICGs’ scrutiny.

Consistent, timely provision of baseline information to ICGs by the above bodies and Ofwat would provide all ICGs with an informed starting point for their scrutiny and challenge. This should include company delivery against performance commitments, as well as regulatory priorities and concerns. The trial provision of such information to the Challenge Co-ordination Group (COG) of ICG Chairs convened by CCW has proved successful, also enabling questions and discussion about the information provided. Such an arrangement would not preclude companies providing information and data to the ICG, in fact it may well stimulate improved information provision.

The COG has proved to be a forum that enables the ICG Chairs to share best practice and learnings from overcoming new challenges. This role should be formalised, with regular discussions scheduled on different aspects of independent challenge and the success factors and barriers that the ICG Chairs have discovered.

Appendix A – Terms of Reference

Aim of the Review

The ultimate aim of the review is to assist ICGs and help to strengthen the challenge to the companies.

Phase 1: The review will identify the differing strengths and weaknesses of the ICGs as they are currently implemented, producing a report which identifies the reasoning behind this decision with recommendations for any suggested remedial action, or sharing of best practice.

Phase 2: The output of this stage of the review is intended to inform both Ofwat's assessment of the quality of the challenge to company plans at PR24 and learnings for effective challenge arrangements at subsequent price reviews. It will assess the adoption of, or reaction to, the recommendations from Phase 1, the extent to which ICGs and companies are complying with the effective challenge checklist from Phase 1⁴⁸, and provide a view of the overall strength of the ICG challenge arrangements.

Objectives

We expect the review to consider the following aspects of each ICG. CCW has developed these areas with input from the ICGs through the COG meetings. They also consider Ofwat's standards for challenge, published in its position paper on Customer Engagement Policy for PR24.⁴⁹

Independence

The review will assess the degree to which the ICGs operate independently of the company's interests, including how well they are able to demonstrate this independence. The review will look for evidence that an ICG is sufficiently empowered to challenge its company in a robust and constructive manner without censure. It will also consider the effectiveness of this challenge, including companies' responses.

This part of the review will assess companies' response to the removal of the mandate from Ofwat to have Customer Challenge Groups as part of the price review process. Is the company still clearly committed to receiving and acting upon strong local challenge as part of its business planning process?

Membership and Expertise

The review will consider the level of expertise among the Chairs and members of each ICG. This will be linked to the stated remit of the groups – is the ICG adequately resourced, in terms of the skillset among its members, to undertake the tasks it is anticipating.

- How were members appointed, was this independently of the company?
- Are members experts in a particular field or stakeholder representatives for a particular organisation?
- To what extent do CCW, Environment Agency, Natural Resources Wales and DWI contribute to the ICG?

⁴⁸ See Appendix C

⁴⁹ Ofwat (n 5)

Resources

The review will consider if the ICG is sufficiently resourced to carry out its stated functions. This will include the remuneration budget, whether this covers only the Chair or includes other remunerated expert members. Is adequate independent administrative support available to the ICG or is the group reliant on company support?

Board Access

The review will consider the visibility of and importance given to the work of the ICG by the company Board.

- Does the ICG have unmediated access to the company Board, with regular attendance by company Board members at ICG meetings and vice-versa?
- Is there a clear process outlining how the work of the ICG will influence the Boards sign-off of the business plan and long-term strategy?

Constitution and Clarity of Role

The review will consider if the ICGs are formally constituted with clear purpose, function and governance detailed in a Terms of Reference that has been agreed with both the Executive and Board of the Company. The review will determine how clear the remit of each ICG is and the extent to which the local challenge arrangements are set up to enable the groups to fulfil their stated functions. This will include reviewing the capacity of the ICG to deliver its workload, which may include the following:

- Delivery of existing commitments to customers
- Quality of ongoing operational learning from customers and implementation of these learnings
- Quality of engagement & research for the purposes of forward planning
- Translation of learnings from all elements of citizen engagement & research into future strategy including how well this links into the PR24 Business Plan

Transparency

The review will consider both how transparent the company is in its sharing of information with the ICG and how transparent and visible the work of the ICG is to interested stakeholders.

- Is the information provided to the ICG by the company in relation to its activities and business planning shared in a timely manner and with adequate context in relation to company performance (both historically and in relation to the rest of the sector)?
- Are details of the work of the ICG easily available? Are agendas, minutes and a record of both challenges and company responses to these challenges published on a dedicated ICG website/page? Is this information updated regularly and in a timely manner?

Appendix B – Phase 2 research process

We conducted the research between September and December 2023. It had four elements.

- Review of documentation
- Workshop with CCW representatives on ICGs
- Questionnaire to ICG Chairs
- One-to-one interviews with ICG Chairs and with company representatives most directly involved with the ICG

Review of documentation

- ICG reports on their scrutiny of the PR24 business plan and process plus challenge logs
- References in the company business plans to the ICGs' work and role

Workshop with CCW representatives

- Representatives on a selection of ICGs; a mix of policy managers and consumer advocates
- Covering their views on the PR24 customer challenge arrangements and the effectiveness of the individual ICGs they were members of

Questionnaire to ICG Chairs

- Topics scrutinised and responsibility for their selection
- Information provision and resourcing of the ICG's scrutiny by the company
- The company's responsiveness to challenge
- Reporting arrangements and contact with the company board
- Effectiveness of the ICG's scrutiny
- Response to recommendations from Phase 1 of the Review of ICGs
- Usefulness of various aspects of the Challenge Co-ordination Group (COG) meetings

At Phase 1, the 16 independent ICG Chairs completed the questionnaire. Only 15 completed the Phase 2 questionnaire; one Chair declined to participate as contact by the company had ceased in May 2023. For the Group chaired by the company CCO, an ICG member and a company representative each completed a questionnaire at both phases so all questions could be answered.

One-to-one interviews

Covering how well the process of ICG scrutiny went in the lead up to the submission of PR24 business plans, the usefulness of the ICGs' input, responses to the Phase 1 recommendations, the value of COG meetings and views on the future role for ICGs. Interviewees spoke on a confidential basis. All but one ICG Chair and at least one representative from each company were interviewed (at some companies more than one staff member attended the call).

Appendix C - Checklist for effective ICG challenge

Behaviours

- Company: welcoming 'uncomfortable' challenge
- ICG: acting as a critical friend, not just a critic
- Both: having honest conversations as issues arise

Governance

ICG Terms of Reference include

- A clear remit: set out a common objective for the company and the ICG that is outcome-focused and customer-centred
- The ICG's source of authority and role: set out the source of the ICG's authority to act, along with a high-level view of what effective delivery looks like
- Board accountability: make clear how the Board will discharge the ICG related part of its accountability for customer challenge

Operational

- Right mix of members
 - subject expertise
 - quality of challenge
 - constructive approach
- Independence guarded
 - processes and behaviours established
 - written down
- Providing relevant information
 - appropriate level
 - comparative data
 - wider perspectives
- Resourced appropriately
 - sufficient time to scrutinise
 - appropriate secretariat support and timely updating of online material
 - sufficient engagement from the Management Team and technical experts

Appendix D - Topics scrutinised by ICGs

Number of ICGs expecting to scrutinise topics vs actually scrutinising⁵⁰

	Expected (Phase 1)	Actual (Phase 2)	Net +/-
Customer engagement/research	16	16	-
Affordability	15	15	-
Stakeholder engagement/research	15	15	-
Delivery in customers' interests	15	14	-1
Vulnerability	15	14	-1
Environmental improvements	15	13	-2
Community engagement	15	12	-3
Resilience	15	10	-5
Leakage	14	12	-2
Long-term considerations	14	11	-3
Water usage	13	12	-1
Pollution	13	11	-2
Company-specific enhancement schemes	13	10	-3
Net zero	13	10	-3
Customer Service	13	9	-4
Drought	13	8	-5
Social value	13	7	-6
Delivery against Ofwat's expectations	12	12	-
Reliability	12	11	-1
Diversity and Inclusion	12	10	-2
Value for money	12	8	-4
CSOs	11	9	-2
Innovation	10	9	-1
Investment	10	7	-3
Corporate responsibility	10	5	-5
Local government engagement	9	4	-5
Digital and data	7	3	-4
Finance	6	2	-4
Workforce resilience	5	5	-
Supply chain	4	5	+1
<i>Additional topics – Phase 2 list only</i>			
Triangulation of customer evidence	n/a	13	
Water resources management	n/a	12	
Statutory investment programmes	n/a	9	
Social contract	n/a	5	

⁵⁰ Data from the 16 ICGs who completed Phase 1 and Phase 2. Data from the ICG Chair completing only Phase 1 is not used.