

SOUTH EAST WATER CUSTOMER PANEL ANNUAL REPORT FOR 2015/16

WHAT ARE THE HEADLINE MESSAGES FOR THE COMPANY AND ITS CUSTOMERS?

- As soon as the last Ofwat price review (PR14) was completed, SEW converted its Customer Challenge Group into a Customer Panel that has been monitoring in detail how the Company is performing against the measures agreed with the regulator for the period 2015-2020.
- In Ofwat's Final Determination (FD) for SEW, a total of 24 Outcome Delivery Incentives (ODIs) were set by the regulator. These measures are of two kinds: 16 traditional measures based on 'hard' units such as time, volume or incidents and 8 novel measures based on customer perception of Company performance.
- Of the 16 traditional measures, SEW met 11 - 2 were missed (the most serious failure being in respect of interruptions), 2 were within the performance 'deadband' range (acceptable tolerance), and 1 is due for completion by the end of the five year period.
- Of the 8 new customer satisfaction measures, SEW met 1 - 5 were missed (the lowest score being in respect of satisfaction with leakage), 1 was within the performance 'deadband' range (acceptable tolerance), and 1 is based on a target at the end of the five year period.
- SEW has been bold and innovative in adopting an ODI package with a set of customer perception measures, but it still needs to be bolder and more innovative in the development and implementation of initiatives that will make a meaningful and timely impact on the scores for these measures.
- On the level of complaints, the Company has achieved a 38% reduction in the last year and an 84% reduction over the past four years. A new social tariff has been successfully introduced and achieved a take-up rate 53% above target. The Company has won three awards at industry events, including one specifically for the focus the business has now given to customer satisfaction at every contact.
- By the end of 2017, the Customer Panel will have a new independent Chair, revised terms of reference and a refreshed membership in order to play its role in Price Review 19 (PR19).

WHAT IS THE COMPOSITION OF THE PANEL AND HOW DOES IT OPERATE?

Ofwat, the regulator of water services in England and Wales, conducts a review every five years of company business plans including how investments should be funded through borrowing of capital and prices charged to customers. For the last such review called Price Review 14 (PR14), Ofwat required each company to establish a Customer Challenge Group (CCG) that would study how well the company engaged with its customers on what they wanted from the company and what they were prepared to pay and how well the company reflected this customer engagement in the proposed business plan that it submitted to Ofwat.

At the time that it submitted its Business Plan for PR14, South East Water (SEW) was already so convinced of the value of this challenge model that it undertook to create a successor body to monitor the actual delivery of the Business Plan once that plan was finally approved by Ofwat. So, as soon as the PR14 process was completed, the CCG was transformed into a Customer Panel with new terms of reference and a revised membership. SEW is to be commended for seamlessly maintaining a customer body with no interval or gap. In this respect, it was ahead of many other companies.

The CCG was chaired by Roger Darlington who was selected in an open recruitment process as a longstanding consumer advocate who was totally independent of the company. Following the completion of PR14, he agreed to continue chairing the new Customer Panel for a couple of years and then to step down so that the Company can recruit a new Chair for the PR19 process. Again SEW is to be commended for being one of the first companies to appoint its CCG Chair through an open process, a practice now followed by all companies.

As well as the Chair, four former CCG members agree to continue serving on the new Customer Panel in order to provide a degree of continuity: Karen Gibbs (CCWater), David Howarth (Environment Agency), Caroline Farquhar (formerly Tonbridge and Malling Citizens Advice Bureau) and Janet Hill (Swale Borough Council). However, six new members were appointed to reflect the different, more customer-focused role of the Panel and to introduce fresh perspectives: Penny Shepherd (CCWater), Angela Dacombe (Age UK), Veronica McGannon, Adrienne Margolis, Ben Roome (household customers) and Richard Lavender (business customer).

CCWater has offered training on PR19 for CCG members nationwide and six colleagues from SEW's Customer Panel have indicated a wish to attend such a course.

Meanwhile the Panel has been meeting quarterly in its role as monitor of SEW's implementation of PR14 and it has now met five times. At the core of each of our meetings is a detailed review of all the data on how the Company has performed against the Outcome Delivery Incentives (ODIs) which have been agreed with Ofwat as part of the Final Determination (FD) at the end of PR14.

In order that Panel members gradually learn more and more about the water sector and that the Company is challenged in more detail on key aspects of its performance, at our meetings we have had a series of what we call 'deep dives' where we ask the Company for a detailed paper and we devote a special period of time to discussing it. So far, we have had 'deep dives' on water quality, environmental issues, and leakage. Future 'deep dives' will look at interruptions, customer interactions, and water resources.

The Panel has already instituted a Challenge Log to record the major challenges to SEW and the Company's response to them as the PR19 process begins to get under way.

At all times, the Panel has sought to operate openly and transparently and publish as much material as possible on a dedicated section of the Company's web site.

Links for further detail

Terms of reference of the Panel:

<http://www.southeastwater.co.uk/media/7138/South%20East%20Water%20Customer%20Panel%20TOR%20Final%20Published.pdf>

Biographical details of Panel members:

<http://www.southeastwater.co.uk/about-us/our-business/customer-panel/introducing-the-customer-panel>

Minutes of Panel meetings:

<http://www.southeastwater.co.uk/about-us/our-business/customer-panel/customer-panel-document-library>

HOW HAS THE COMPANY PERFORMED AGAINST HARD MEASURES?

In Ofwat's Final Determination (FD) for SEW, a total of 24 Outcome Delivery Incentives (ODIs) were set by the regulator and agreed by the Company.

These measures are of two kinds:

- a) 16 traditional measures based on 'hard' units such as time, volume or incidents which are derived from key Company data
- b) 8 novel measures based on customer perception of Company performance which are derived from independent surveys

Of the 16 'hard' measures, SEW has met 11 of them but fallen short on five. The targets on discolouration contacts and mean zonal compliance were only just missed and were within the acceptable tolerances of the measures; the breaches of abstraction licences & discharge consents were minor if regrettable; and the number of sites at risk of flooding is planned to be reduced to zero by the end of the five year period.

The one significant failure was interruptions to supply where a major incident at Hailsham (involving a strategic mains burst) very early in the financial year meant that the relevant annual target was never going to be met. The

Company did brief the Panel fully on this incident and shared with the Chair of the Panel the full management report on it.

If the one incident of Hailsham was excluded, the target would have been met. Of course, Hailsham cannot be excluded, but the Company was right to continue publicising among staff the interruptions figures with and without Hailsham, so that staff did not lose focus on the need to continue to minimise interruptions even after Hailsham.

The 16 'hard' measures – some of them quite obscure to ordinary customers - are as follows:

- Level of leakage – the target of 91.8 megalitres a day (MI/d) was comfortably met with an achievement of 88.1 MI/d.
- Service Incentive Mechanism – the target of >80 was exceeded with an achievement of 82.0 which probably equates to a ranking of 11th out of 18 water companies.
- Number of properties at risk of low pressure – the target was 60 and the achievement was 53.
- Average time lost per property from interruptions – the target of 12.7 minutes was substantially exceeded at 32.1 because of the Hailsham incident (but, without that incident, it would have been 9.1 so we hope for better performance in the rest of the price control period).
- Frequency of discolouration contacts – against a target of 0.97, actual performance was 0.98 (but, although SEW was slightly above its discolouration contacts for 2015 it reduced such contacts by 17% compared to the prior year).
- Meeting the water resource deficit – the target was that there would be no deficit and there was none.
- Mean zonal compliance (a measure of the water quality at customers' taps) – the target was to have 100% compliance but actual achievement was just below at 99.96% and above the company's internal target of 99.95% which we understand is in line with the industry average.
- Above ground asset performance – the target was to be stable and this was achieved
- Water mains bursts – the target was 2,429 and this was beaten with 2,307.
- Breaches of abstraction licences, discharge consents and environmental permits – the target was zero but there were actually 25, although these were all relatively minor if regrettable and categorised as green using an agreed Environment Agency banding approach.
- Number of serious pollution incidents - the target was that there would be none and there was none.
- Number of compliance breaches of health and safety legislation - the target was that there would be none and there was none.
- Number of compliance breaches of national security obligations - the target was that there would be none and there was none.

- Number of breaches of other statutory obligations and licence conditions - the target was that there would be none and there was none.
- Number of sites at risk of flooding – the target for the price review period is there would be none but there are currently 55 and the company plans to reduce this to zero by 2019/20.
- Amount of carbon emissions per customer per year – the target was 38.7 kgCO₂e/customer by 2019/20 and at 36.8 this was exceeded in the first year of the price review period.

The Customer Panel is aware that many customers have a real concern about leakage levels in particular, so we asked SEW to provide us with additional information so that leakage can be seen based on litres per property per day. Based on data as at 2014/15, we found that SEW has a better achievement than 12 other companies in the UK (seven companies were better than SEW and in one case no data was available). This is an encouraging finding and, together with the Company's achievement on the traditional measure, shows commendable progress on leakage.

Overall, therefore, SEW has done moderately well on the 'hard' measures, but to a large extent this is to be expected since these measures are essentially 'business as usual' and in particular one does not expect compliance breaches. The Panel understands that, while it is right and proper that companies aim for zero compliance breaches, it is tough actually to achieve this. We have been advised that, in reality, the Company would expect a small number of (environmental) compliance breaches but would like to see this reducing year on year, trending to zero.

HOW HAS THE COMPANY PERFORMED AGAINST CUSTOMER SATISFACTION MEASURES?

In the preparation of its Business Plan for PR14, SEW – with the full support of the CCG – developed an innovative approach to the measurement of outcomes where it did not simply measure what the Company does but measure how customers feel about what it does. These new measures have been all about customer satisfaction.

As an example of the traditional and new measures, take the issue of leakage which is the loss of water from the supply network. Leakage can be measured in different ways but all involve looking at the actual volume of water concerned and usually the measure used is megalitres (1,000 cubic metres) per day and leakage targets are derived from something called the Sustainable Economic Level of Leakage (SELL). Now SEW has met its SELL target for the last 14 years, but customers have no real understanding of what this measure means and show high levels of concern about what they perceive the amount of leakage to be. So a customer perception measure of leakage would ask customers how satisfied they are with the level of leakage rather than asking the company what was the actual amount of leakage.

The previous Customer Challenge Group and the present Customer Panel have both been very supportive of SEW in its adoption of this innovative approach to setting outcomes by measuring what customers are thinking rather than relying on what the network and systems are revealing. But we have always recognized that this approach has risks:

- It is new to the sector so we cannot be sure how it will work.
- We do not yet understand what it is that shifts perceptions and therefore customer satisfaction upwards.
- Customer satisfaction can be influenced by factors outside the Company's control such the weather, the actions of other water companies, and the media.
- After a first year with no rewards or penalties attached to these measures, for the final four years of the price review the Company stands to lose money if it fails to achieve the target scores for each measure.

These customer perception measures compare the results of monthly surveys of 100 customers (or, in the case of bills, an annual survey of a large number of customers) against a baseline performance that was derived by a one-off survey of 1,000 customers carried out in September/October 2013. The baseline survey and the ongoing monthly surveys have all been carried out independently by Accent Marketing and Research.

Unfortunately, of the 8 customer satisfaction measures, SEW has only managed to meet 1 of its targets: that on frequency of restrictions (note that there have not been any restrictions now for four years). All the other targets of this kind were missed – although 2 only just - with the score for leakage especially low.

The 8 customer satisfaction measures are as follows:

- Customers consider the appearance of their water to be acceptable – the target was 4.6 and the actual performance was 4.4.
- Customers consider the taste and odour of their water to be acceptable - the target was 4.3 and the actual performance was 4.1.
- Customers consider the level of leakage to be acceptable - the target was 4.0 and the actual performance was 3.4.
- Customers consider their direct interaction experience to be positive - the target was 4.5 and the actual performance was 4.2.
- Customers consider their water supply is of sufficient pressure - the target was 4.5 and the actual performance was 4.2.
- Customers consider the frequency and duration of supply interruptions are acceptable - the target was 4.7 and the actual performance was 4.6 (which is within the deadband range).
- Customers consider the frequency of water use restrictions to be acceptable - the target was 4.1 and the actual performance was 4.2.
- Customers consider bills to be value for money and affordable – the internal target was 72% and the actual performance was 71%. The

Final Determination target is to achieve 80% by the end of the five-year period.

Customer satisfaction measures are difficult to measure and difficult to achieve. It can be hard for customers to give an informed view of issues such as leakage or interruptions when they may not have witnessed either for some time (if at all) and it is hard for many customers to assess how the company handles direct interactions because most customers most of the time do not need to interact with the water company. Therefore, when setting the baseline in the autumn of 2013 and carrying out the monthly surveys in 2015/16, the proportion of customers answering 'don't know' was sometimes quite high, especially as regards assessing satisfaction around leakage (36% 'don't know' in 2015/16) and direct interaction (31% 'don't know' in 2015/16).

Another fundamental issue is whether the baseline data is a robust and fair benchmark against which to compare current levels of customer satisfaction. It was always SEW's intention that the ODI regime and related performance commitments would serve to maintain customer satisfaction across the Business Plan period, except for leakage where an improvement is being targeted. However, in the case of 7 out of 8 of the measures in 2015/16, the Company has fallen short of the baseline.

In theory, this could be because SEW performance has fallen since the baseline was constructed but actual performance data makes it clear that this is not the case. Having carried out further customer research and discussions with Accent, the Company feels that the one-off survey which set the baseline for these measures needs to be recalibrated and has sought Ofwat's support for revising its approach.

The Panel has genuine sympathy towards the case for a new baseline, but:

- We are clear that this is a matter for Ofwat and not something that we should support or oppose since it is not just a measurement issue but potentially has financial consequences for the Company.
- We are strongly of the view that any recalibration would have to be a one-off exercise with no further revisiting of the targets in this price control period.
- We would expect that that any change should have a neutral affect on customers.
- We did invite the Company to consider an alternative approach of running with the same targets for another year and Ofwat extending to that year the non-application of rewards and penalties, but the Company felt that this would unbalance the whole reward/penalty package.

Of course, the point about perception measures is that the Company is incentivised to engage with its customers in a manner that is intended to change perceptions. SEW has made available to the Panel information on a wide range of initiatives intended to improve Company performance. These initiatives are, of course, very welcome but, as regards the impact on

customer perception measures themselves, we would make the following observations:

- It was December 2013 when SEW submitted to Ofwat the Business Plan setting out its innovative approach to ODIs with the proposal that 8 of these measures be based on customer perception. We are not sure that the Company used the time prior to the commencement of the current ODI regime as well as it should to develop initiatives that would impact on customer perception from April 2015 to March 2016. The review of the brand is welcome but should have been carried out before perception measures came into force rather than being carried out throughout the first year of these measures. Even now, some of these initiatives – such as leak aware and leak fix signs - are in the planning or trial phases rather than fully rolled out.
- A number of the proposed initiatives, while welcome in themselves and likely to improve customer service, are – in the view of the Panel - not really focused on changing customer perception. For instance, the launch of the new vision and values, the development of employee training, and the operational engagement programme will not we suspect of themselves have a sizeable impact on customer perception. We know that the Company believes that these initiatives will affect how staff behave and interact with customers and that this will not only directly impact satisfaction but also positively impact perception. In so far as this proves to be the case, however, these initiatives will give customers that come into contact with the Company a “better experience” but this is likely to only be a relatively small proportion of the total customer base (much lower than in the past because of the successful reduction in the number of complaints).
- Some of the initiatives that clearly are focused on impacting customer perception will – in our view – have limited influence in the near term. We are not sure how much the proposed customer magazine and letter to parish councils will be read and would recommend some testing of their impact. The upgrade of the web site, the greater use of social media, and a programme of community talks are sensible measures but are unlikely to have a significant impact for some time. SEW has confirmed that it is planning to test satisfaction before and after the proposed magazine and letters so that any impact can be understood. It has also confirmed that it will trial two different magazine types.

In short, SEW has been bold and innovative in adopting an ODI package with a set of customer perception measures, but it still needs to be bolder and more innovative in the development and implementation of initiatives that will make a meaningful and timely impact on their scores.

Panel members are not themselves experts in this complex area and, in any event, it is not our job to tell the Company how to manage its relationship with its customers. But we were pleased to be able to facilitate contact between SEW and Advizzo which we understand has led to a productive collaboration.

And we would encourage the Company, as they have told us they are doing, to continue looking actively at ideas elsewhere in the sector and in other sectors and to seek dialogue with bodies like the Institute of Customer Service, the Consultation Institute, and the Behavioural Insights Team.

HOW HAS THE COMPANY PERFORMED AGAINST OTHER CRITERIA?

When the CCG was first established, we were very concerned about the volume of complaints made by SEW's customers. In 2011/12, SEW had the worst complaints record of any company in England and Wales and its rate of complaints per 10,000 customers was three times the national average. We took our concerns to the Board and made them clear in our submission to Ofwat on the Company's proposed Business Plan for 2015/2020.

The Customer Panel has been really pleased to see the substantial and sustained reduction in complaint numbers achieved by the Company in the last four years. The figures are as follows:

Financial year	Number of complaints
2011/12	13,095
2012/13	8,787
2013/14	6,261
2014/15	3,474
2015/16	2,145

That is a 38% reduction in the last year and an 84% reduction over the past four years. This is highly commendable and we hope that this trend will continue.

Another area of activity that the Panel has been monitoring closely is the new social tariff introduced by SEW in 2015/16. The CCG had observed that some 30,000 might be eligible for the new social tariff but that, taking into account the current level of subsidy that customers will support for the five years of the Business Plan, some 15,000 could be expected to be on the tariff by 2019/20.

If take-up was to be at the same rate throughout the five-year period, we might expect the number to have signed up to the social tariff to be around 3,000 by the end of 2015/16. In fact, take-up has been consistently higher than target and by the end of the financial year stood at 4,581 – some 53% above what might have been expected. This shows that the Company is reaching customers eligible for the special tariff and that eligible customers are taking advantage of it and the Panel is very pleased with this progress.

Looking at the overall performance of SEW, we recall the comment made by the CCG in its submission to Ofwat on the Company's Business Plan for PR14: *"Although historically SEW has been a well-performing company, it has not traditionally shown evidence of a wish to be best in class."* In the course of the PR14 process, the CCG encouraged SEW to be more aspirational and ambitious in its planning and performance.

In the same spirit, the Panel has been keen for SEW to be more assertive and higher-profile in the water sector since we feel that it has a good story to tell, not least around its innovative approach on measuring customer perception. One of our very first entries in the new Challenge Log states: *“The Panel would like the Company to get more involved at presenting at industry workshops and conferences to raise its public profile.”*

We have been pleased, therefore, to see Dave Hinton, Asset & Regulation Director, and Jo Osborn, Head of Communications, presenting at recent conferences and Dave Hinton being interviewed in “The Water Report” on the Company’s approach to customer satisfaction measures.

Also we have been very pleased to see SEW winning some significant awards:

- At the national Water Industry Achievement Awards, winning Customer Satisfaction Initiative of the Year for the ‘Five out of Five’ customer satisfaction programme
- At the national Water Industry Achievement Awards, winning People Initiative of the Year for the ‘Perfecting Performance Programme’
- At the Institute of Water’s National Innovation Awards, winning the National Innovation Award for novel use of testing for the presence of newts using DNA found in water samples.

The Panel sees real evidence that SEW is upping its game and this is very welcome.

WHERE DOES THE COMPANY AND PANEL GO FROM HERE?

When the Customer Panel was created in the Spring of 2014, it was always envisaged that, after around two years, it would transition into a Customer Challenge Group (CCG) to engage the Company in the PR19 process. Roger Darlington, Chair of the CCG and then the Panel, planned to step down at this time.

Effectively, however, PR19 has already commenced and the Chair and the Panel have found themselves increasingly involved in discussions about the conduct of the price review with particular relevance to the role of CCGs, the nature of customer engagement, and the centrality of outcomes.

Therefore, Roger Darlington and SEW have agreed to bring forward the recruitment of a new independent Chair with a view to a phased handover concluding by the end of 2016. The new Chair will probably wish to revert to the use of the name Customer Challenge Group, will need to revise the terms

of reference to embrace the PR19 process, and will no doubt review and refresh the membership in the light of the developing role.

CIRCULATION OF REPORT

SEW Board
SEW senior management team
SEW web site
SEW Environment Focus Group
Ofwat
Environment Agency
Drinking Water Inspectorate
Natural England
CC Water nationally
CC Water regionally
All Customer Challenge Group Chairs
New Energy & Water Public Interest Network
Water UK
“Utility Week”
“The Water Report”