

Information notice

IN 16/08 July 2016

ofwat

This is a formal document that alerts our stakeholders to a change in the way that we regulate the water sector in England and Wales.

The process for determining the application of in-period outcome delivery incentives

This information notice explains our policy in relation to determining the application of in-period outcome delivery incentives (ODIs). By “in-period” we mean ODIs which are applied during the five-year price control period rather than at the end of the period. The ODIs which are applied in-period were agreed at the 2014 Price Review (PR14).

2015-16 was the first year for which in-period ODIs were payable. Payments will be made by adjustments to revenue for the year 2017-18. **In-period ODIs only apply to three companies during this price review period: Anglian Water; Severn Trent Water and South West Water.** Payments can take the form of:

- a penalty paid by a company to compensate customers for performance below its committed performance level; or
- a reward received by a company to reflect stretching levels of performance provided to customers beyond its committed performance levels.

Background

We introduced in-period ODIs at the 2014 price review (PR14). Three companies chose to adopt in-period ODIs following consultation with their customers and agreed to a change to their licences.

In-period ODIs increase the power of incentives by bringing a reward or penalty closer in time to the actions that earned it.

They are also likely to reduce the size of adjustments at price reviews.

The process set out in companies' licences

The modification made to the [licences](#) for Anglian Water; Severn Trent Water and South West Water at PR14 sets out some key features of the in-period ODIs determination process. The relevant text is in paragraph 12

of Condition B of the three companies' licences. This can be summarised as follows:

1. A company can make a claim for its in-period ODIs no later than 15 September. Ofwat can also initiate the determination process.
2. A company must provide Ofwat with whatever information we "may reasonably require for the purpose of making a determination".
3. In making the determination Ofwat can consider the company's performance in relation to its in-period ODIs in preceding and future years (not including the years covered by the next price review).
4. Ofwat will make the determination no later than 15 December.

Further details on the in-period ODI process

The licence text, intentionally, does not describe in detail how the in-period ODI determination process operates. This allows for the process to evolve as we, companies and other stakeholders learn from experience. This section sets out further details on the process for making determinations in relation to performance in 2015-16, for which companies need to request a determination by 15 September 2016 (or Ofwat can initiate the process).

In relation to the three companies (Anglian Water, Severn Trent Water and South West Water).

- Given the timeline, and our desire to publish draft determinations, we would expect companies to make us aware of the likely content of their in-period claims

earlier than 15 September. If a company plans to submit its claim early we would be grateful if it would inform us of this in advance.

- A company's request for a determination must be accompanied by information about what reward or penalty payment it considers is appropriate for each in-period ODI, its supporting evidence and whether its request differs in any way from the automatic operation of the in-period ODIs as set out in the company's final determination company-specific appendix (subject to any amendments through its corrigenda or recalibration of ODI rates).
- If a company is not claiming the full net reward or penalty implied by the automatic operation of its in-period ODIs, the company must provide all its evidence in support of this.
- The company must explain what impact its reward or penalty claim will have on its customers' bills. The company should also explain what engagement it has had, or will have, with customers and other stakeholders about the bill impact in the context of the overall bill and other changes to the bill e.g. for inflation or the K factor agreed at PR14.
- The company must submit the completed [ODI spreadsheet from the PR14 reconciliation rulebook](#).
- The company must submit a completed version of our "[K factor model](#)" for calculating the adjustment to K.
- We expect the performance a company reports for 2015-16 on its in-period ODIs to be the same as that reported in its annual performance report. If this is not the case the company must provide an explanation for why it is not the case.

- The company must explain to us whether it considers that its performance on any of its in-period ODIs in 2015-16 is exceptional in any way and whether this requires it to consider measures to smooth bills.
- We require a company to explain whether and how any mitigating factors (e.g. weather, third party actions or exceptional events) have been applied to its reported performance for each in-period ODI and its justification for applying any mitigating factors. In such cases, the company should provide assurance on its judgment that a mitigating factor applies and how it has been applied.
- The company should explain whether there was any ambiguity in the definition of each of its in-period ODIs, how the company interpreted the ambiguity and what assurance it obtained on its interpretation of the ambiguity.
- The company must explain what internal and external assurance, including from its Customer Challenge Group (CCG), the company obtained for its in-period ODI claim. We require assurance that the information provided is accurate and complete.

In relation to Ofwat.

- We plan to issue a draft determination for a short consultation, probably in late October, before issuing our final determination no later than 15 December.
- If any of the three companies with in-period ODIs does not request a determination of its in-period ODIs, we have the ability under the company's licence to initiate the determination process and require the information we need to make the

determination, if we consider this is appropriate.

The PR14 Reconciliation rulebook

The [PR14 reconciliation rulebook](#) explains how inflation, the time value of money and tax are applied to ODIs. In brief:

- ODIs can be adjusted for inflation as set out in the rulebook
- ODIs cannot be adjusted for the time value of money
- ODIs can be adjusted for tax as set out in the rulebook

In its request for an in-period ODI determination the company should explain how it has made adjustments for inflation and tax and how these accord with the policy set out in the PR14 reconciliation rulebook.

Relationship to licensing discussions for PR19

We are currently discussing with companies a licence modification to allow for in-period ODIs for all companies at the next price review (PR19). These discussions are separate to the in-period ODI determinations for PR14 (including in relation to 2015-16 performance).

Enquiries

If you have any questions about this information notice please email jon.ashley@ofwat.gsi.gov.uk

More information

[Water company licences](#), most recent versions

[The PR14 reconciliation rulebook](#), July 2015,

[The company-specific appendices to the PR14 final determinations](#), December 2014,

[The K factor model](#): The model for calculating the adjustment to wholesale price limits (the K factor) resulting from the application of in-period outcome delivery incentives (ODIs), July 2016,

Ofwat (The Water Services Regulation Authority) is a non-ministerial government department. We regulate the water sector in England and Wales. Our vision is to be a trusted and respected regulator, working at the leading edge, challenging ourselves and others to build trust and confidence in water.

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