A consultation on the outcomes framework for PR19

Consultation response from Anglian Water – January 2017

Contents

Executive Summary

We welcome this opportunity to respond to the outcomes consultation and build on both our significant engagement in outcomes development through PR14 and the initial dialogue regarding the Water 2020 programme.

Overall, the increased focus on outcomes in PR14 has increased companies' focus on delivering services which really matter to customers. The development and evolution of the outcomes approach for PR19 should continue to have customers at its heart, with the results of customer engagement being the main influence on a company's final suite of outcomes and associated incentives. We wholeheartedly support the proposals for making performance commitments more transparent for customers. We would also support any move to make the overall outcomes framework clearer and more transparent for customers.

The long-term nature of the water sector and the critical stewardship role that companies have in relation to the environment and the needs of future customers as well as today's customers means it is critical that any proposed changes to this framework continue to incentivise companies to innovate, plan and invest in a way which delivers long-term benefits to customers.

It is also important to recognise that the discussion of the evolution of outcomes is just one component of the overall suite of regulatory building blocks for the next Price Review. Judgements on the right calibration of outcome delivery incentives (ODIs) will need to be taken in the round and taking into account the wider Risk and Reward considerations which will follow ahead of the July draft methodology paper.

In the following paragraphs we set out our views on the main principles of the proposed PR19 outcomes framework. Specific references to the questions set out in the consultation document are highlighted in parentheses.

Resilience *(Q8)*

We welcome the proposal to reflect resilience more clearly within the outcomes framework. It is important for the industry to prepare for future challenges so that services for future customers and the environment can be safeguarded.

We welcome resilience being better reflected in the common performance commitments and ODIs and support the development of common resilience measures. Resilience is a multi-faceted topic so to allow meaningful comparisons between companies and over time, we believe more than one measure may be needed. We are actively engaged in developing resilience metrics, through WaterUK and the Water and Wastewater Resilience Action Group (WWRAG), and with the National Infrastructure Commission on their work on performance measures and believe that the outcome of this work should be considered by Ofwat as it considers responses to this consultation.

Whatever measures are chosen, however, it is imperative that they are designed based on assessment of the future risk, and thus on a forward-looking basis, rather than against historic performance.

Comparability of measurement *(Q1,2 & Q3)*

We support the improved provision of comparative information to customers and stakeholders to help them challenge companies to improve performance. Initiatives such as Discover Water, which we have supported throughout its evolution, represent positive developments in this area.

With the potential for greater rewards and penalties being linked to common performance commitments, it is important that rewards and penalties truly reflect actual differences in performance.

We recognise that:

- Rewards for ODIs should be earned only through delivering levels of performance which propel the industry frontier
- Customer Challenge Groups (CCGs) should be able to challenge companies' proposals for performance commitments with reference to performance delivered by other companies
- The ability of CCGs (and companies) to do this was limited at PR14 by the non-availability of this information.

The development of successful common measures at PR19 depends on developing consistent definitions. The experience of PR14 tells us that work on ensuring consistency of definitions for any proposed measure should be done <u>before</u> rather than <u>after</u> a measure becomes a common performance commitment.

Reaching agreement on definitions and measurement methods should be co-ordinated at an industry level. We actively supported the projects initiated by WaterUK to develop consistent definitions for leakage, supply interruptions and sewer flooding. This reminded us of the large variation in definitions and approaches between companies for measuring these performance commitments. It also highlighted the time and effort necessary to reach agreement on these matters; this should not be overlooked in planning future activities.

To ensure trust and confidence, we think great care should be taken in setting targets until consistent definitions have been agreed, that all companies are reporting against those consistent definitions, and that Ofwat has systems in place to ensure companies act in compliance with them. For common performance commitments to be also subject to comparative assessment, stretching targets can only be set if there is a robust historical dataset of performance levels that have been collected on a consistent basis for a number of years. This has implications for the nature of commitment levels that might be set at PR19; without the availability of a robust historical dataset before the final determination, it may be necessary to set performance targets dynamically as more robust datasets emerge during AMP7.

We remain ready to support initiatives to develop consistent definitions for measures deemed suitable for a common approach. It would be preferable for any such initiatives to commence as early as possible so that clarity is available during companies' customer engagement programmes and as they develop their business plans.

As a final general point, linked to increasing the power of ODIs, we recognise that placing greater weight on comparability of information will create additional resource and assurance requirements within the regulatory system for companies, CCGs and Ofwat.

Selection of common performance commitments *(Q2)*

We agree that a set of principles provides a good framework for assessing whether a performance commitment is suitable to be included as a common performance commitment. We have compared the principles proposed by Ofwat against those proposed in the Economic Insight report for Thames Water and noted that Ofwat's list encompasses those proposed by Economic Insight.

We agree that the number of common performance commitments should be relatively small. To crowd out company-specific commitments which fit with customer preferences (which will vary across the country) with a long list of centrally dictated ones would seriously undermine the fundamental principle on which all stakeholders are agreed: companies' plans should be founded on customer priorities.

Principle four states that the common performance commitments should use consistent definitions. We think this should be extended to say ' … and all stakeholders are confident that those definitions are being applied in the same way by all companies.' In the absence of arrangements to deliver that confidence, the value of common performance commitments will not be realised. We question whether Ofwat currently has the capacity to assess whether all companies are reporting in accordance with the same definitions, and believe this is therefore an important issue warranting further consideration.

We have sought to assess each of the ten proposed common performance commitments against the common performance commitment principles (except principle 1 which is not applicable to a single measure). We have also proposed an alternative measure Distribution input / Domestic Property (more details on this are provided later on in this response). For ease of understanding we have applied a RAG shading. We have also provided comments on whether to apply a common commitment level, for those six measures where Ofwat has suggested it. The table below summarises our views:

Proposed common measure	Matters to customers /resilience	Overlap with others	Consistent definitions	Future customers
1. Future customer experience measure	Work on new measure ongoing			
2. Water quality compliance measure				
3. Customer water supply interruptions				
4a. DI				
4b. Leakage				
4c. Per capita consumption				
Alternative proposal: DI / Domestic Property				
5. Abstraction incentive mechanism				
6. Customer property sewer flooding (internal)				
7. Wastewater pollution incidents				
8. Water mains bursts (asset health water)				
9. Sewer collapses (asset health wastewater)				
10. Possible new common measure of resilience	Work on new measures ongoing			

We have captured our detailed consideration in tabular form in the appendix to this document.

Based on our review against the principles, we therefore support the inclusion of seven of the ten common performance commitments.

However, we do not support the introduction of common performance commitments for the Abstraction Incentive Mechanism, water mains bursts (asset health water) or sewer collapses (asset health wastewater).

Price control-specific ODIs *(Q2)*

We agree that performance commitments for ODIs related to those areas where there is competition for the provision of services are unnecessary.

As performance commitments should be related to outcomes that customers want, these could overlap across more than one price control. For PR14, this situation mainly arose between the wholesale and retail interface where the demarcation of impact was relatively clear, or where an appropriate allocation could be chosen. For example, SIM has a 50:50 weighting between billing and operation.

For the new price controls, in particular for water resources, the contributions of each price control to the final outcome are less clear. For example, it may be unclear or difficult to calculate what proportion of water taste complaints can be attributed to water resources or to water distribution (network plus). Given the likely limited number of cases of outcomes overlapping price controls and the likely arbitrariness of allocating some outcomes between specific price controls, it would be preferable and simpler for ODIs to be allocated to individual price controls, provided this does not negatively affect outcomes for contestable markets.

Application of common performance commitments *(Q3)*

It is important that there is a robust framework for selecting common performance commitments which is underpinned by confidence in companies reporting performance on an equivalent basis.

The option framework in the consultation for applying comparative assessments is helpful. As the parameters in the framework are linked (e.g. Type of assessment, Basket, glidepath etc); our expressed views need to be taken as a package.

Data quality and comparability is central to applying performance commitments. We consider confidence in the data is likely to constrain the suite of upper quartile targets that can feasibly be set.

In principle, we think dynamic targets most closely mimic what happens in contestable markets and should therefore be regarded as the optimum approach. Our support for dynamic targets is in the context of their being used in a basket approach. Dynamic targets are the only option in the situation where we do not have a solid and reliable record of historical performance levels against which to set a fixed commitment levels. For example, we do not have confidence that there will be a reliable performance dataset on supply interruptions (measured against the newly developed consistent definition) at the time final determinations are published in 2019. We expect one to emerge during AMP7, provided the definition is enforced appropriately, and could be used to set dynamic targets.

The use of dynamic targets also has the benefit of removing the need for forecasts, which can anyway be problematic.

We would not support the use of a dynamic ratchet. This is because this could require companies to achieve a level of performance linked to one year's exceptional performance that could have been influenced by uncontrollable external factors (such as mild weather) and which is not representative of the historical trend in performance.

We do not see the value for customers of lagged targets nor do we support them on grounds of market mimicry. Furthermore, where measures are more susceptible to external factors, we propose averages rather than annual values be used.

Upper quartile and baskets of measures *(Q3)*

We consider setting an upper quartile target in every performance area is unrealistic. It is also unrepresentative of the dynamics of a contested market, where the overall performance of competitors represents the balance of their respective strengths and weaknesses. In a contested market successful companies also choose to allocate resources and focus towards those dimensions of service which are most valued by their particular customers.

Observing these features leads us to suggest it would better to consider companies' performance across a range of measures rather than to treat each measure in isolation. Precedent and a template for such an approach exist in water regulation in the form of the Overall Performance Assessment (OPA), which was used to incentivise performance.

The key features of the OPA were:

- It included a basket of measures covering various key dimensions of service; weights were applied to reflect their relative value to customers;
- Ranges of performance were defined for each measure, based on historical performance levels reported by companies
- Annually a company's performance against each measure was converted to a number of points, according to its position within the range
- Companies earned a reward or a penalty at the end of each period, according to the total number of points they had scored compared to each other (similar to the conversion of SIM scores to rewards and penalties at PR14).

In our response to the Water2020 discussion paper in September 2015 we included a proposal for how a dynamic version of the Overall Performance Assessment (OPA) could be introduced. We remain of the view this approach has merit and we have replicated this detail in the appendix.

Common reward and penalties *(Q3)*

It is important that the link between individual company rewards and penalties and customer valuation is maintained. If the societal valuations derived by companies (based on a triangulation of valuation methods) and companies' customer engagement processes are robust, then the variation between companies' values will legitimately be different. That said, we are open to the idea that there should be a degree of convergence on incentive rates.

Company-specific factors *(Q3)*

We think it right to retain the option of making allowances for the impact on performance of factors that are outside company control.

We recognise the value of early submissions with business plans. However, we also recognise that a company's need to submit a company-specific factor claim will depend on the scale of challenge it faces against the new target, which will not be apparent at the time of business plan submissions. A requirement for early submission therefore risks numerous 'insurance' claims which may prove to be unnecessary, creating substantial abortive work and an increased burden for both companies and Ofwat.

More powerful ODIs *(Q7)*

In principle, we agree that ODIs should be made more powerful such that a greater proportion of companies' revenues are dependent on the quality of service they have provided. This ensures that companies' incentives are aligned with the interests of their customers and replicates the forces observable in contested markets.

However, unless ODIs are calibrated well there are risks for customers and companies associated with making them more powerful and real practical considerations which must be addressed. Specifically, we think that we can only move to more powerful ODIs if we are confident about the following:

- The reliability of the performance level reported by an individual company
- The parameters of the ODI: that is, is the performance commitment insufficiently stretching or unduly aggressive? Are the incentive rates correctly calibrated with customers' valuations of service improvement?
- The data and methodologies which underpin the calculation of those ODI parameters: has the industry dataset from which performance commitments been selected been compiled on a consistent basis? Are willingness-to-pay estimates sufficiently robust to support the customer valuations?

We suggest that in most areas there is more work to be done before all these tests are passed and we could safely move to increasing the power of ODIs.

With this proposed shift to companies earning a higher proportion of their returns through ODIs for delivering high quality service to customer it is important that these incentives, once committed through Final Determinations are applied using a certain, transparent, and mechanistic regulatory process. Failure to do this would introduce undue uncertainty.

It is important that there is no additional uncertainty associated with the transition to higher rewards and penalties for ODIs. Were this to happen it could increase the level of risk perceived by investors, which in turn could increase the required returns to be recovered through the weighted average cost of capital, and create a disbenefit for customers.

With regard to the range of wider options for making more powerful ODIs we would expect that companies should be able to apply these at their own discretion (e.g. the choice of in-period ODIs and revenue or RCV backed ODIs) in collaboration with customers and CCGs in developing the optimal balance. On this basis we advise against over-prescription. This is consistent with the desire for companies to take a longer-term view, and supports the position that the decision about the type of ODIs should primarily be a matter for companies and their customers and CCGs.

There are specific considerations that need to be addressed prior to implementation. Firstly, these more powerful incentives must be targeted to areas that customers identify as being priorities – i.e. the level of incentive should recognise the level of importance of the measure to customers.

Secondly, to give companies and customers confidence the rewards and penalties must be driven by genuine company outperformance rather than driven by either exogenous factors beyond companies' control or differences in information capture or reporting practices.

Finally, when developing higher powered incentives, we think it important to avoid undue complications. On this basis, we consider the addition of a cost of equity menu as an overly complex element and we do not support its introduction.

Asset health *(Q2 & Q9)*

Our views on the range of proposals in the consultation relating to Asset Health are mixed.

We are strongly supportive of Asset Health forming part of companies' overall approaches to outcomes and incentives. This is consistent with the company-specific approaches taken at PR14.

However, we do not agree with the principle of developing a single comparative measure for Asset Health. Such a move would represent a significant change from the historic approach to asset health and we do not consider it would have a discernible positive impact for customers.

Instead of a single comparative measure, we would support the continued development and application of company-specific Asset Health measures and incentives. This enables approaches which reflect key company-specific circumstances such as inherited legacy assets and wider company circumstances (e.g. geology and climatic conditions) all of which impact on asset health. Such an approach will better incentivise companies to continue to improve long term capital maintenance planning, tailored to their specific circumstances, and focussed on delivering best value for customers today and in the future.

We agree that companies should continue to provide more clarity to customers and their CCGs on their approaches to reporting asset health.

However, the use of common performance indicators to reflect asset health risks oversimplifying the complexity of companies' maintenance approaches.

For example, we would strongly disagree with using mains bursts as a common measure. This is because it would not reflect the actual impact on the services provided to customers. Nor does it align with companies' wider performance and incentives on specific service aspects such as leakage control which proactively seeks to detect and repair leaks.

Leakage *(Q4)*

We are disappointed with the assertion in the consultation that companies' outperformance on leakage in 2015-16 suggests that performance commitments at PR14 might not have been set at a sufficiently challenging level.

For Anglian Water, our leakage target was set at an extremely stretching level. Our performance has been achieved due to significant increases in investment, optimisation of our operational systems and sustained focus from senior management teams across the business. We also note that we have been helped by a milder than average winter which resulted in fewer bursts and associated leaks.

If there is a belief in the value of incentives being strengthened, it is important that the implied regulatory contract can be depended upon. Incentives could be undermined if companies subsequently found themselves being 'penalised' through targets being increased if they are met, due to an unfounded conclusion that the original target was set too low.

In general, we are largely supportive of the views expressed in the consultation that companies should:

- take into account their long-term expectations of the future value of water, the scope for water trading and the resilience of their supplies when considering their leakage commitment levels;
- aspire to, and plan to achieve much more challenging leakage targets in the future and, if a company is not committing to a downward trend in leakage, then it will need to provide robust evidence for why this is the case
- ensure that their future leakage targets are reflected in their future demand forecasts and that these are consistent with their water resources management plan (WRMP) or that any differences are explained.
- Assess leakage on the basis of at least 3 year rolling average. This is because we see leakage reduction as a long term challenge, and we expect some ups and downs in the short term due to weather and other factors. The long term trend will determine the success of the long term strategy and this can only be measured by 3 or even 5 year averages.

Factors informing setting performance levels in bespoke commitments *(Q5)*

We do not think there are any areas that all companies should cover with their bespoke performance commitments, including performance commitments related to customers in circumstances which might make them vulnerable.

We do not think there should be a separate measure for vulnerable groups within an overall customer experience measure; it should be for companies to decide whether they propose an individual performance commitment in this area.

Notwithstanding our view that it would not be appropriate to include a *requirement* for companies to include a separate bespoke measure for vulnerable groups, we do believe this is an area that all companies should focus on. We would therefore suggest that there may be opportunities for companies to tailor their approaches to vulnerable customers by sharing information and industry best practice.

We have worked with Ofwat in the past to set out the substantial developments we have implemented in relation to customers in vulnerable circumstances in recent years, and remain open to working with other companies and key stakeholders to improve outcomes in this area.

We agree with the principles set out previously that companies should use a range of customer insight (e.g. day-to-day information) and valuation information (e.g. WTP studies, revealed preference) to inform both the proposed investment in companies' plans and the proposed rewards and penalties for companies' ODIs.

We support Ofwat's previously stated view that this evidence should be robust, balanced and proportionate to the scale of investment proposed. We would expect this to be reflected in Ofwat's approach to assessing companies' proposals through the risk based review.

We welcome the greater use of triangulation of different valuation methods, and note that this will require more qualitative assessments to be made, rather than just quantitative assessment. We would expect this to be reflected in the forthcoming guidance, rather than relying on specific mechanistic approaches to benefits and costs which could undermine companies' ability to reflect fully customer preferences in their business plans.

In order for marginal and incremental costs data to be a useful tool for stakeholders as with other comparative performance information, the data would need to be collected and presented on a consistent basis.

Although we support the sharing of more information with stakeholders, we are concerned that as marginal and incremental cost data can be based upon a (sometimes limited) number of company-specific historical schemes, it may be difficult to provide a robust dataset that can be used by stakeholders to make comparisons between companies without detailed prescriptive guidance.

We recommend that, should Ofwat be minded to proceed with collecting marginal and incremental costs, this should be on a specific subset of measures and schemes where it would be possible to assure the quality and consistency of the data provided.

New customer experience measure *(Q6)*

The appendix accompanying this summary sets out the detail of our comments on each of the eight key questions on the potential new customer experience measure set out in the consultation. We note that further, substantive full consultation on the revised measure will follow when Ofwat consults in future on specific measures.

At a high level, we welcome the development of a new customer experience measure for PR19 and support the general direction to develop greater understanding of the customer experience at a more disaggregated level.

We also support the general direction of travel of reflecting companies’ wider channel offerings and the need to reflect the range of ways that both companies and customers engage. This would include the addition of outbound contacts from companies rather than solely focusing on inbound.

We agree with the need to reflect vulnerability as a priority. Any measures developed around vulnerability need to be designed such that the incentive to identify and support those most in need is retained, without the creation of an unduly complex process.

Making performance commitments more stretching

Q1: What is your view on the use of improved information, including comparative performance information, to make performance commitments more stretching?

We recognise that:

- Rewards for ODIs should be earned only through delivering levels of performance which propel the industry frontier
- CCGs should be able to challenge companies' proposals for performance commitments with reference to performance delivered by other companies
- The ability of CCGs (and companies) to do this was limited at PR14 by the non-availability of this information.

We also recall that at PR14 Ofwat retrospectively attempted to define some common ODIs on the basis of the proposals companies had made in their plans. Their ability to do this was hampered by the same non-availability of information and the fact that each company had – as guided – developed a range of bespoke ODIs that were not necessarily consistent with those developed by others. For the kind of approach to outcomes suggested in this consultation, success at PR19 depends on developing consistent definitions for common measures. The experience of PR14 tells us that work on ensuring consistency of definitions for any proposed measure should be done before rather than after a measure becomes a common performance commitment.

Reaching agreement on definitions and measurement methods has to be co-ordinated on an industry level. We actively supported the projects initiated by WaterUK to develop consistent definitions for leakage, supply interruption and sewer flooding. This reminded us of the large variation in definitions and approaches between companies for measuring these performance commitments. It also highlighted the time and effort necessary to reach agreement on these matters; this should not be overlooked in planning future activities.

To ensure trust and confidence, we think great care should be taken in setting targets until consistent definitions have been agreed and all companies are reporting in compliance with them. For common performance commitments to be also subject to comparative assessment, stretching targets can only be set if there is a robust historical dataset of performance levels that have been collected on a consistent basis for a number of years. This has implications for the nature of commitment levels that might be set at PR19; without the availability of a robust historical dataset before the final determination, it may be necessary to set performance targets dynamically as robust datasets emerge during AMP7.

We remain ready to support industry initiatives to develop consistent definitions for measures deemed suitable for a common approach. It would be preferable for any such initiatives to commence as early as possible so that clarity is available during companies' customer engagement programmes and as they develop their plans.

Risk Based Review tests

We agree that it is for companies to decide the best approach for engagement and provision of information to their customers and other stakeholders and have supported greater weight being given to the quality of customer engagement in the assessment of business plans. We agree that it would not be desirable to include a specific test in the risk-based review for the 16 comparative measures.

Q2: What is your view on the common performance commitments we are suggesting for PR19?

We agree that a set of principles provides a good framework for accessing whether a performance commitment is suitable to be included as a common performance commitment. We have compared the principles proposed by Ofwat against those proposed in the Economic Insight report for Thames Water and noted that Ofwat's list encompasses those proposed by Economic Insight.

We agree that the number of common performance commitments should be relatively small. To crowd out company-specific commitments with a long list of centrally dictated ones would seriously undermine the fundamental principle on which all stakeholders are agreed: that companies' plans should be founded on customer priorities.

Principle four states that the common performance commitments should use consistent definitions. We think this should be extended to say ' … and all stakeholders are confident that those definitions are being applied in the same way by all companies.' In the absence of arrangements which provide that confidence the value of common performance commitments will not be realised. We question whether Ofwat currently has the capacity to assess whether all companies are reporting in accordance with the same definitions, and believe this is therefore an important issue warranting further consideration.

We have sought to assess each of the ten proposed common performance commitments against the common performance commitment principles (except principle 1 which is not applicable to a single measure) in the following table. The table includes a potential alternative measure DI / Domestic Property for which more details are provide later on in our response. For ease of understanding we have applied RAG shading. We have also provided comments on whether to apply a common commitment level, for those six measures where Ofwat has suggested it.

Based on our review against the principles, we support the inclusion of seven of the ten proposed common performance commitments. We do not support the inclusion of the Abstraction Incentive Mechanism, water mains bursts (asset health water) or sewer collapses (asset health wastewater). Following the table we provide some more reasoning for not supporting the inclusion of these measures.

	Matters to customers/resilience	Overlap with others	Consistent definitions	Future customers	Comments on whether to apply common commitment level (CL)
1. Future customer experience measure	NA (work on new measure ongoing)				Cannot comment until measure is defined
2. Water quality compliance measure	Definitely – It is our core business and people expect safe clean drinking water.	No overlap.	If we use an industry measure from the DWI (like MZC or the new DWI company risk score) we are confident it will be consistently interpreted and enforced across the industry already.	Exceptional water quality compliance will remain an expectation for our future customers.	Unsure. The DWI's new company risk score measure will not go live until 2018. It could be difficult to set a CL until all parties understand it better.
3. Customer water supply interruptions	Definitely. Strong candidate as the best possible measure of customer service in supply network.	Synergy with leakage but affects stakeholders in different ways so OK to include both	WaterUK consistency project has established a consistent definition but how soon will companies be able to report to it? Who will enforce compliance to it? What about companies' different levels of network monitoring?	Improvements to assets and operational practices that help current customers will also benefit future customers	Yes but only once all companies can demonstrate compliance with the definition • Highly weather susceptible so three year average better than single year • Probably not enough history of reporting against new definition so CLs would have to be dynamic
4a. DI	Yes – being able to rely on a sustainable water supply is the highest customer priority	DI is linked to leakage from the company assets and private customers' supply pipe leakage. It is also linked to commercial and industrial sales and domestic consumption	Although it is very simple to defined, it is heavily influenced by volatility of sales to industrial customers. Making consistent comparisons between undertakers and between years is difficult because of this	Levels of abstraction now influence the quality of the environment future customers will enjoy	
4b. Leakage	Definitely, our customers have told us that reducing leakage is one of their main priorities	Leakage performance overlaps with DI and with the Water Abstracted. Leakage from private supply pipes overlaps with water delivered volume	Leakage estimation is a complex process. The industry initiative to work on a consistent definition will help but the complexity of the process will mean that there is some appreciable uncertainty in the definition	Levels of abstraction now influence the quality of the environment future customers will enjoy	
4c. Per capita consumption	Yes – being able to rely on a sustainable water supply is the highest customer priority	PCC overlaps with DI and Water Abstracted	The main weakness of this definition is the estimate of the occupancy rate which is uncertain. A simpler and more reliable measure of the consumption is the Per Property Consumption which is derived from meter reading and Household Consumption Monitors	Levels of abstraction now influence the quality of the environment future customers will enjoy	

	Matters to customers/resilience	Overlap with others	Consistent definitions	Future customers	Comments on whether to apply common commitment level (CL)
DI / Domestic Property A proposal from AWS, this captures, DI, Leakage and per capita consumption and is easy to measure	Yes – being able to rely on a sustainable water supply is the highest customer priority	Yes, it covers DI, Leakage and consumption as well as Water Abstracted. This measure will also cover the benefits of the water efficiency efforts	It is a simple measure to report because it is made up of hard numbers that are relatively simple to derive; DI (after deduction of commercial use) and the number of domestic properties served by the company.	Levels of abstraction now influence the quality of the environment future customers will enjoy	
5. Abstraction incentive mechanism	While it is clear that our customers strongly support leakage reduction, it is not clear that they would value a mechanism which acts very locally, on a small number of days per year and at a very small number of sites. The vast majority of customers would not benefit from the AIM in any way, whereas all customers benefit from wider water efficiency measures.	This measure aligns to ensuring we maintain a flourishing environment, specifically about our abstractions and the resulting effect on the environment. This is already covered by the DI / leakage / PCC measure which is also about making sure we use resources wisely and do not waste them.	We have not yet seen the first reporting of this measure, but it is likely that companies will have chosen different definitions for baseline and threshold values. It would be difficult to ensure consistency across England and Wales as the local environmental circumstances vary so widely across the region, as does rainfall, on which the operation of the mechanism ultimately depends.	The EA are now implementing abstraction reform. There should not be any need to continue with the AIM once abstraction reform has concluded.	
6. Customer property sewer flooding (internal)	Definitely. Strong candidate as the best possible measure of customer service in collection	Synergy with pollution incidents but affects different stakeholders so OK to include both	WaterUK consistency project has established a consistent definition but how soon will companies be able to report to it? Who will enforce compliance to it? What about the antecedent rainfall exemption?	Improvements to assets and operational practices that help current customers will also benefit future customers	Probably, but … • Highly weather susceptible so three year average better than single year • Needs allowance for exceptional weather (not severe weather)? • Normalisation dependent on companies' estimates of private sewer length which is very uncertain • Likely not enough history of reporting against new definition so CLs would have to be dynamic
7. Wastewater pollution incidents	Yes, especially for those who are keen to protect the environment	Synergy with flooding incidents but affects different stakeholders so OK to include both	Environment Agency Common Incident Classification System	Improvements to assets and operational practices that help current customers will also benefit future customers	Yes but • Highly weather susceptible so three year average better than single year • Normalisation dependent on companies' estimates of private sewer length which is very uncertain

	Matters to customers/resilience	Overlap with others	Consistent definitions	Future customers	Comments on whether to apply common commitment level (CL)
8. Water mains bursts (asset health water)	No. Customers are concerned about the potential consequences for service - leakage or supply interruptions	Overlaps with supply interruptions and leakage. Disincentivises leakage detection, and supply interruptions is a better indicator of customer outcomes.	No consistent definition has been developed in AMP6. One would need to be developed. WaterUK highlighted that companies question whether it is appropriate to regards this as an outcome measure in its letter to Ofwat on 14th October 2016.	Improvements to assets would benefit customers over the long term.	No – no common definition, highly weather susceptible and companies' assets differ significantly
9. Sewer collapses (asset health wastewater)	No. Customers are concerned about the potential consequences for service – pollution incidents, flooding and impacts of highway repair	Sewer collapses cause other service failures such as flooding and pollution incidents. They are a subset of wider customer issues.	No consistent definition has been developed in AMP6. One would need to be developed.	Improvements to assets would benefit customers over the long term.	No – no common definition, companies' assets differ significantly and normalisation is dependent on companies' estimates of private sewer length which is very uncertain
10. Possible new common measure of resilience	NA (work on new measure ongoing)				Cannot comment until measure is defined

Abstraction incentive mechanism

We do not think there is a need for the Abstraction Incentive Mechanism. This is because there are existing regulatory mechanisms to ensure that if company abstractions are causing damage to the environment, they will be addressed and reduced where necessary.

If the AIM does continue into AMP7, we agree that the best place to start is from the existing AIM, as developed by the AIM taskforce, and that this group is best placed to recommend further development of the mechanism. We remain of the opinion that the mechanism should be reputational rather than financial, as in principle we do not believe we should be rewarded for stopping damage to the environment. We believe that if water companies are continuing with environmentally damaging abstractions this should be addressed through existing environmental regulation, rather than requiring a reward to incentivise a change in activities.

Should the mechanism become financial in the future, there will need to be careful consideration of how the incentive rate is calculated. Several options have been put forward including willingness to pay, an environmental valuation, and marginal cost. We think any incentive rate must be aligned to customer willingness to pay, and could include elements of a value placed on the environmental benefit. We should consider natural capital alternatives in any assessment of benefits. We do not think that marginal cost should be considered, as it provides no incentive for companies to deliver financially efficient solutions, and is not representative of customers' willingness to pay or the benefit delivered to the environment.

Water mains bursts (asset health water) and sewer collapses (asset health wastewater)

Incentives for maintaining asset health have been a permanent feature of the post-privatisation regulatory environment. Below we list the key features of the serviceability measure used until 2015:

- A basket of measures rather than a single one
- Basket included service measures as well as asset health measures
- Components of the asset base considered separately (water / sewerage, infra / non-infra)
- Performance assessed across-time within a company rather than across-sector
- Trends rather than single year's performance considered
- Opportunities for discretion to be applied to account for exceptional circumstances

We regarded most of these features as correct, and incorporated most of them when designing our bespoke serviceability ODI for AMP6. The one feature that we did not retain was the final one. We considered that allowing for an element of discretion provided too much uncertainty for all stakeholders. Furthermore, it made it much more difficult to provide clarity and transparency about the incentive for customers and other stakeholders. Our AMP6 ODI design therefore incorporated absolute pass/fail tests which removed much of the previous ambiguity. We believe that any new asset health or serviceability measure should retain the principles present in our AMP6 design. The proposal to use any individual measures of water mains bursts and sewer collapses breaches the 'basket' principle; one measure cannot be used on its own to assess the health of an asset base comprising billions of pounds worth of varied and diverse assets. The further proposal to apply common commitment levels breaches the 'across-time within company' principle; the age, condition and nature of assets vary significantly between companies and cannot be expected to perform similarly.

There are further reasons to oppose the use of mains bursts and sewer collapses. Firstly, there is neither a common industry-wide method for recording them nor any initiative in hand to develop one. Secondly, being judged on the number of mains bursts and sewer collapses disincentivises beneficial activities which enhance network intelligence. After the drought of 2010-2012 and subsequent harsh winter of 2012-13 which caused a big rise in our leakage, we significantly increased our leak-detection effort. A consequence of this was a big increase in the number of bursts we found and reported. Thus we could risk being penalised for pursuing a strategy with widespread customer support and significant benefits for the environment.

A similar argument would apply to sewer collapses. If we were to be judged purely on the number of sewer collapses it could discourage us from undertaking the CCTV programmes that provide us with valuable intelligence about our wastewater network.

Customer water supply interruptions

We have taken an active role in the WaterUK work to develop a more detailed definition of supply interruptions. The proposed measure aligns with our current PR14 measure, so we would not be impacted by having to change our reporting. We welcome Ofwat's proposal to adopt this as it is a more standardised measure than the current measure.

We do not yet consider that there is a level playing field in terms of measuring supply interruptions because companies have varying levels of ability to report against the new definition. Where companies do not have telemetry coverage their estimates of time and number of customers affected are likely to be much lower than those with coverage. This situation is likely to continue for some time while companies make the necessary investment.

Even companies with similar levels of network telemetry coverage may use the data they have in different ways. Some companies may use the data to model a worst case scenario, while others may use a best case scenario (the likelihood is that the majority of companies are somewhere in between, but this will still leave variance in reporting).

The WaterUK project proposed introducing confidence grades to highlight the different approaches to interruption extent validation. This recommendation has not been referenced in this consultation, however we see it as a vital part of assuring that inconsistencies in companies' reporting are acknowledged.

Water distribution input / leakage / per capita consumption

We agree that leakage is a significant issue for customers so would support the principle of a common performance commitment as this would allow customers to compare companies and their leakage control efforts.

We would not support distribution input being used as a common performance commitment. Although distribution input is simple to measure, the trend change in distribution input is influenced by the volatility of industrial demand, especially for small sized water only companies.

Neither would we support per capita consumption being used as a common performance commitment. Although per capita consumption is a direct measure of customer demand it is derived using estimates of occupancy that are based upon population and occupancy estimates that are highly unreliable and can change significantly following a census. A better alternative to per capita consumption is per property consumption that is directly measured through billing.

A potential alternative to the 3 proposed measures that could be used is a DI / Domestic Property index. DI / Domestic Property as a measure would capture and incorporate the main features of leakage, DI and per property consumption. DI / Domestic Property is calculated by first deducting the commercial and industrial demand from DI, then dividing the remainder by the total domestic properties. This measure would show which companies are producing water more efficiently as a result of actively reducing leakage and promoting water efficiency. From April 2017, retailers will also be able to compare the per customer consumption by dividing their total commercial and sales by the number of businesses they serve.

Other areas

We now provide comments on the other areas where Ofwat has asked for views.

In-period ODIs

We agree with the advantages and disadvantages of in-period ODIs set out in the consultation document. One additional concern we have is whether in-period ODIs encourage companies to focus on short-term targets rather than taking a longer-term view consistent with the long term nature of the sector and the importance of the stewardship role for the environment and the supply-demand balance that water companies play. If true, this might stifle strategic planning and innovation where the return is realised in the longer term, which would not be in the interests of customers or stakeholders.

On balance, it is likely that a mixture of in-period and period-end ODIs may be appropriate, with more focus on period-end given the factors we describe above. We agree that all companies should have the flexibility to set in-period or period-end ODIs by the incorporation of the licence modification that we already have. Ultimately we think the decision about the type of ODIs should be a matter for companies and their CCGs.

Bespoke performance commitments – Vulnerable customers

We do not think there are any areas that all companies should cover with their bespoke performance commitments, including performance commitments related to customers in circumstances which might make them vulnerable.

The first stage in including any performance commitment/measurement of service to vulnerable groups is to define consistently which customers would fall within the category of vulnerable. For a measure that is common across companies, and where companies will be compared with each other, the definition needs to be clear, precise and unambiguous. We agree that the new, wider, definition of vulnerability means that customers will move in and out of the category, possibly several times within the same year. We think that it would be very difficult and expensive for water companies to proactively identify all such customers, and so self-identification would be needed.

Recently, as part of developing our engagement strategy for PR19, we held a number of interviews with vulnerable customers. A key point that emerged was that individuals who superficially fit the wider criteria, do not necessarily self-identify as vulnerable or requiring any additional services. This was due to a variety of reasons, including engagement with other, targeted support organisations such as Macmillan or Age UK, and a strong family or other support network around them. We also think that some customers will not want to be identified as vulnerable due to the stigma of being labelled as such. This would mean that any measure that looked at proportion of customers identified as vulnerable, or proportion of take up of services, would not be a measure of company performance, but rather would be a measure of individual preference.

We think that providing services that vulnerable groups might access is part of delivering good customer service to all our customers. As we set out above, self-identification will be key, but may not be an accurate differentiator and indeed may even put some customers off accessing services they could benefit from. So we think services should be offered as available to all (subject to qualifying criteria) rather than labelled as specifically for vulnerable groups.

We also note that the proportion of our total customer base that could fall into the wider definition would be significant. We currently estimate just over 20% of our customer base fall into the narrow definition. This means that any survey of measure of customer satisfaction will, by its nature and design, capture the views of vulnerable customers.

For these reasons we do not think there should be a separate measure for vulnerable groups within an overall customer experience measure, and it should be for companies to decide whether they propose an individual performance commitment in this area.

Although it might not be appropriate to include a requirement for companies to include a separate bespoke measure for vulnerable groups, as this is an area we think all companies should focus on, we believe there are opportunities for companies to better tailor their approaches to vulnerable customers by sharing information and industry best practice. We have already explained to Ofwat the substantial developments we have implemented on this in recent years and remain open to working with other companies in the industry and key stakeholders.

Price control-specific ODIs

We agree that performance commitments for ODIs related to those areas where there is competition for provision of services are unnecessary.

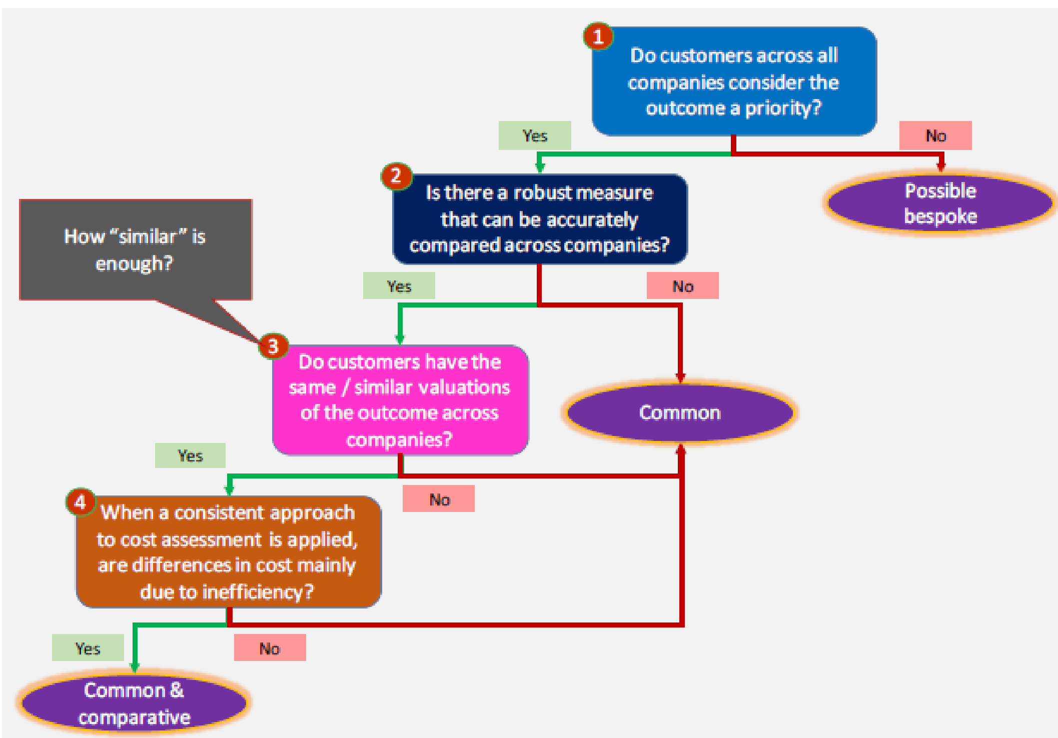
As performance commitments should be related to outcomes that customers want, these could overlap across more than one price control. For PR14, this situation mainly arose between the wholesale and retail interface where the demarcation of impact was relatively clear or an appropriate allocation could be chosen. For example, SIM has a 50:50 weighting between billing and operation.

For the new price controls, in particular for water resources, the contributions of each price control to the final outcome are less clear. For example, it may be unclear or difficult to calculate what proportion of water taste complaints can be attributed to water resources or to water distribution (network plus). Given the likely limited number of cases of outcomes overlapping price controls and likely arbitrariness of allocating some outcomes between specific price controls, it would be preferable for simplicity for ODIs to be allocated to individual price controls, provided this does not affect outcomes for contestable markets.

Q3: What is your view on how we might apply comparative assessments at PR19?

It is important that a robust framework is used to select which common performance commitments are suitable for comparative assessments. We would support the use of the decision tree included in the Economic Insight report for Thames Water[1]. This approach makes the important distinction between measures that are common and those which might be subject to comparative assessments.

Figure 1: Decision tree for choosing between common, comparative and bespoke approaches



Source: Economic Insight

[1] https://corporate.thameswater.co.uk/about-us/our-strategies-and-plans/-/media/3e90726e93744bd88deefe2e9e5ec1e7.ashx?bc=white&db=web&la=en&thn=1&ts=26c8fb4b-91ed-43ad-a17c-c82facba670b.pdf page 11

In the previous section we gave our views on those common measures proposed by Ofwat which we think could also be the subject of comparative assessments. We would agree with the findings of the United Utilities outcomes report that the

> *"strongest case for a common measure being used for targeting purposes is where there are national standards, as for water quality compliance and pollution incidents"*[2] .

The approach of the quality regulators to their respective measures provides the model that should be followed wherever comparative assessments are to be applied. The resource demands of their approaches should be noted.

The option framework for applying comparative assessments set out on page 29 of the consultation document is helpful. We précis it below alongside a summary of our views, which we expend on beneath. It is important to recognise the interaction between these options and that the level of challenge is determined by the way they work collectively. Our preferences should be regarded as a package and not picked selectively. For example, our support for dynamic targets is in the context of their being used in a basket approach.

Option	**PR14**	**AW view**
Type of assessment	Upper quartile	Depends on the consistency of the data on which it is based
Performance data	Historical	Dynamic is best in principle and necessary where a reliable historical dataset does not exist
Annual / average	3 year average	3 year average, especially for measures heavily influenced by weather
Basket / individual	Individual	A dynamic version of the OPA provides the best mimic of contested markets
PC or ODI	Variety	Retain a variety; support convergence of incentive rates towards industry standards
Glidepath	2 years	Retain where new targets are materially more challenging than current industry norms
Company specific factors	Limited	Retain the option for these

Type of assessment
The level of performance challenge should be driven by the level of confidence in the underlying data set. This is analogous to the use Ofwat has always made of cost efficiency models. Our view is that there are very few measures for which we currently have sufficiently robust datasets to enable the setting of upper quartile targets.

Performance data
In principle, we think dynamic targets most closely mimic what happens in contestable markets and should therefore be regarded as the optimum approach. The use of a dynamic target in SIM and its predecessor, the Overall Performance Assessment, is powerful in driving performance as companies remain unsure and fearful of the achievements of their competitors.

[2] http://corporate.unitedutilities.com/documents/Incentives_paper_August_24_2016(1).pdf page 9

Furthermore, we think dynamic targets are the only option in the situation where we do not have a solid and reliable record of historical performance levels against which to set a fixed commitment levels. For example, we do not have confidence that there will be a reliable performance dataset on supply interruptions (measured against the newly developed consistent definition) at the time final determinations are published in 2019. We expect one to emerge during AMP7, provided the definition is enforced appropriately, and could be used to set dynamic targets.

The use of dynamic targets rules out the need for forecasts, which can anyway be problematic.

We would not support the use of a dynamic ratchet, as this could require companies to achieve a level of performance that has been influenced by one year's exceptional performance that could have been influenced by external factors (such as mild weather) or natural variability and which is not representative of the historical trend in performance. We do not see the value for customers of lagged targets nor support them on grounds of market mimicry.

Annual or average

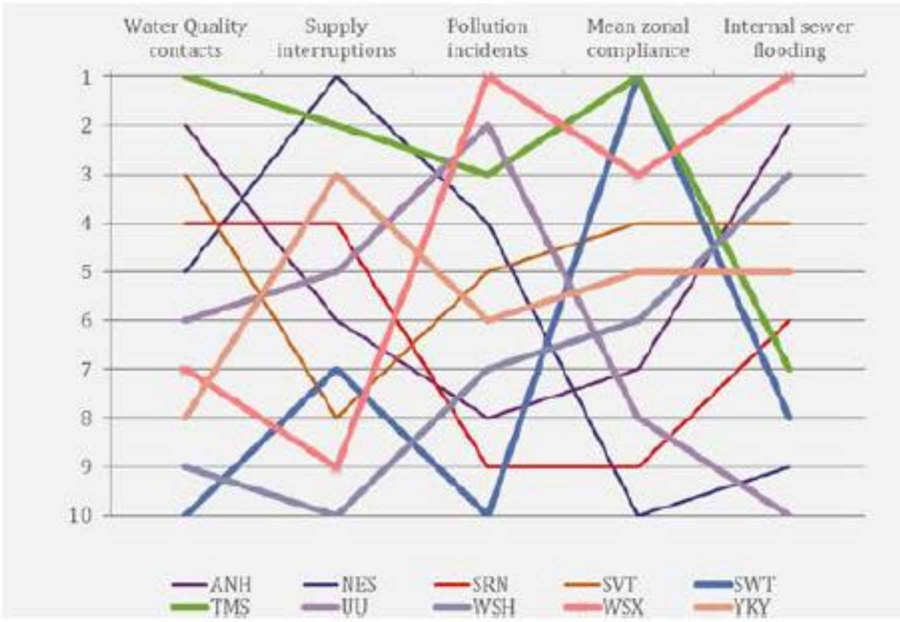
We would support applying the common commitment levels to average data over a period of years (typically three-years) for those performance commitments that are affected by the weather, as this reduces the impact of one-off events.

Individual or basket of measures

All stakeholders recognise that the 'upper-quartile' performing company does not exist. As illustrated in following graph from the Economic Insight/Thames report[3], no company is upper quartile on all of the PR14 comparative assessment measures.

[3] https://corporate.thameswater.co.uk/about-us/our-strategies-and-plans/-/media/3e90726e93744bd88deefe2e9e5ec1e7.ashx?bc=white&db=web&la=en&thn=1&ts=26c8fb4b-91ed-43ad-a17c-c82facba670b.pdf page 69

Figure 19: WaSC's rankings across comparative outcome areas



Source: Economic Insight analysis of Ofwat 'upper quartile comparative assessments' data.

Setting an upper quartile target in every performance area is unrealistic. It is also unrepresentative on the dynamics of a contested market, where the overall performance of competitors represents the balance of their respective strengths and weaknesses. In a contested market, successful companies also choose to allocate resources and focus towards those dimensions of service which are most valued by their particular customers.

Observing these features leads us to suggest it would better to consider companies' performance across a range of measures rather than to treat each measure in isolation. Precedent and a template for such an approach exist in water regulation in the form of the Overall Performance Assessment (OPA), which was used to incentivise performance improvements by companies in the period 2000 – 2010. The key features of the OPA were:

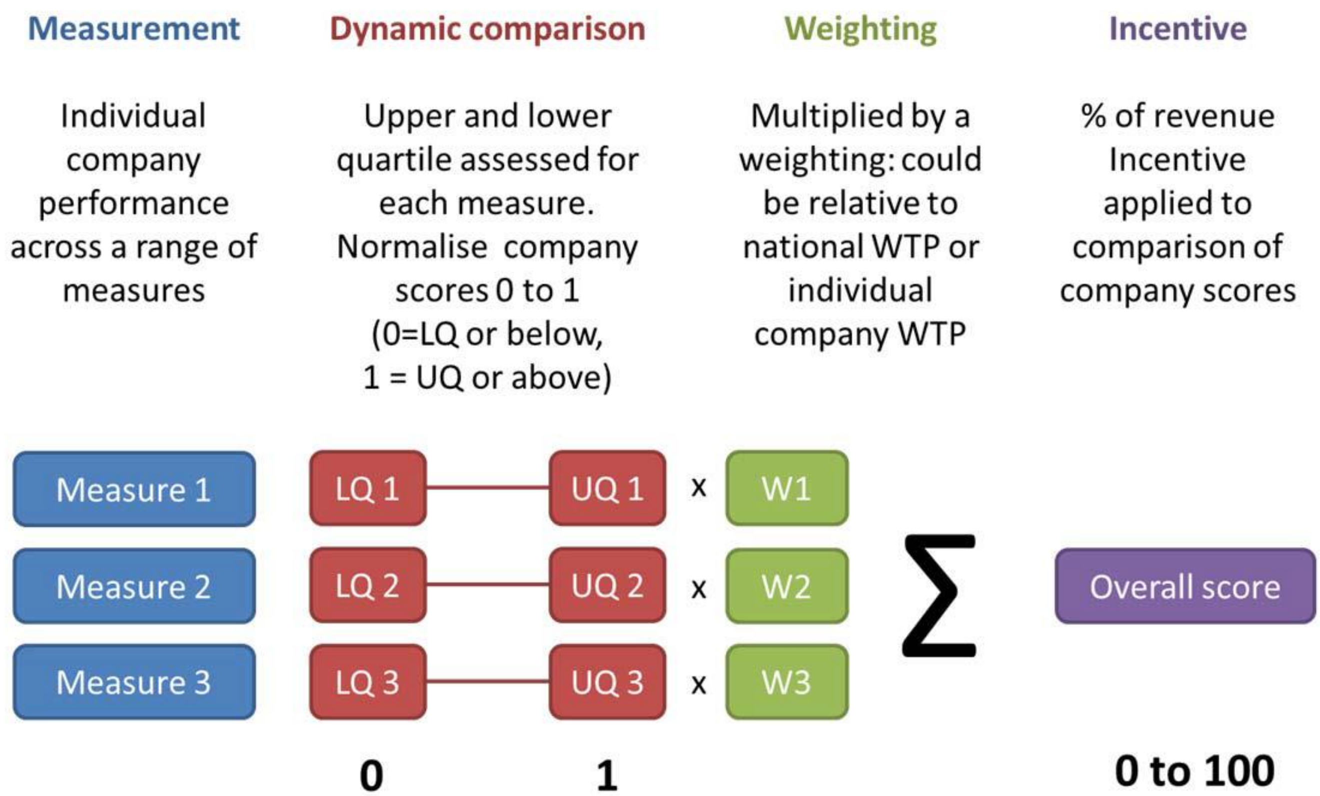
- It included a basket of measures covering various key dimensions of service; weights were applied to reflect their relative value to customers
- Ranges of performance were defined for each measure, based on historical performance levels reported by companies
- Annually a company's performance against each measure was converted to a number of points, according to its position within the range
- Companies earned a reward or a penalty at the end of each period, according to the total number of points they had scored compared to each other (similar to the conversion of SIM scores to rewards and penalties at PR14).

In our response to the Water2020 discussion paper in September 2015 we included a proposal for how a dynamic version of the Overall Performance Assessment (OPA) could be introduced. For convenience, we reproduce our submission in the box below.

Dynamic version of the Overall Performance Assessment (OPA).

One approach would be to consider the reintroduction of a more dynamic version of the Overall Performance Assessment (OPA). By considering a range of outcome measures, combined into an overall score, incentives could then be applied to the overall score, so that genuinely upper quartile performers across a range of service measures can be rewarded and others incentivised to improve.

The major criticism of the OPA before its replacement by SIM was that it was good at ensuring 'acceptable' performance but poor at shifting the frontier, as it relied on absolute levels of performance set by Ofwat. If instead, the points were determined dynamically based on upper quartile performance, a new approach might allow Ofwat to introduce dynamic forward-looking comparative incentives relatively simply. An example of how this might work is shown below, although a number of variations on a similar theme could achieve the same result. We think this might provide an approach to achieving Ofwat's objectives to stimulate dynamic performance improvements in a predictable and transparent way, and would be happy to work with Ofwat in developing options in this area further.



Common reward and penalties
As recognised in the consultation document *"some variation in reward and penalty rates might be appropriate for common performance commitment levels if customers in different regions value the increments in service differently."*

It is important that the link between individual company rewards and penalties and customer valuation is maintained. We are therefore nervous about substituting company-specific values for common ones. If the societal valuations derived by companies (based on a triangulation of valuation methods) and companies' customer engagement process are robust, then the variation between companies should be due to legitimate differences in customers' priorities. However, we recognise the shortcomings of societal valuation and the perversity of incentives varying across the sector. Thus we are open to the idea that there should be at least some convergence on incentive rates.

Glidepaths
The use of glidepaths should be dependent upon the scale of change between current expectations of good industry performance and the new targeted levels of performance. We would support the continued use of glidepaths if there was any move beyond upper quartile commitments as this would represent service levels beyond those that companies were expected at the start of PR19.

Company-specific factors
We think it right to retain the option of making allowances for the impact on performance of factors that are outside company control.

We recognise the value of early submissions with business plans but on the other hand also recognise that a company's need to submit a company-specific factor claim depends on the scale of challenge faces against the new target, which will not be apparent at the time of business plans. A requirement for early submission therefore risks the submission of numerous 'insurance' claims which may prove to be unnecessary, creating substantial abortive work and increased burdens for both companies and Ofwat.

Q4: To what extent do you agree with our proposed approach to leakage performance commitments for PR19?

Before responding to the specific question posed in the consultation, we would like to respond to the assertion in the consultation that companies' outperformance on leakage suggests that performance commitments might not have been set sufficiently challenging. For Anglian, our leakage target was set at an extremely stretching level and outperformance has only been achieved due to significant increases in investment, increased focus from management teams across the business, and optimisation of our operational systems.

The leakage reduction was delivered through a combination of:

- **Network/pump optimisation schemes** - Revised Leakage and Optimisation team structures were put in place in 2014-15 to support the delivery of the leakage reductions required across the AMP. The optimisation team implemented 26 optimisation schemes in 2015-16 delivering 3.07 Ml/d leakage reduction.

- **Intensive leakage programme (the "172 process")** - The 172 team have developed and implemented a seven stage process to categorise each District Metered Areas (DMAs) in terms of its leakage position, validate the data, locate the areas of the network causing the problem and then resolve the problem. This process has now reviewed 342 DMAs resulting in a leakage reduction of 3.32 Ml/d since the process started in February 2015.

- **Increased noise logging resources -** We maintained an elevated level of detection technicians in 2015-16 to mitigate the risk of summer/winter breakout of leaks. An average of 118 technicians was employed over the whole of 2015-16 to search for leaks, compared to the equivalent of 101 in 2014-15. The additional technicians have been employed predominantly to "lift and shift" noise loggers. Planning of the noise logger programme has been designed to focus detection effort town by town. This has allowed efficiencies in the repair process to be delivered by grouping network repair activities into similar locations.

- **Lowest ever backlog of leakage repair jobs –** At the start of this AMP, we have entered into a new 15 year partnership with Kier and Clancy Docwra to form an Integrated Maintenance and Repair (IMR) delivery route. All network repair and maintenance activities are carried out through this route. We have introduced some new performance metrics aimed at ensuring leakage repair jobs that cause the most water to be lost are prioritised as opposed to a target based on outstanding job numbers in the previous contract. Performance under the new contract has been very strong with backlogs at all time lows and volume of leakage from jobs out of Levels of Service (LOS) decreasing from 6 Ml/d at the start of the year to 1.5 Ml/d for the second half of the year onwards.

- **A mild winter causing fewer bursts than normal** - the winter of 2015-16 was a mild winter with a low number of days with minimum temperatures below freezing and a low number of days with consecutive frosts compared to average. We experienced one short cold spell from 17-22 January 2016 which caused temporary increased bursts and rise in leakage of 20 Ml/d. Our low repair backlogs meant that we were able to locate and repair these leaks quickly bringing leakage back to the pre-event levels within a week. We estimate that if we had an average winter then year end leakage would have been 2.8 Ml/d higher.

As outlined in the Ofwat's previous discussion paper the "The role and design of incentives for regulating monopoly water and sewerage services in England and Wales" it is important that an incentive has a potential for gain and loss.

> *"Risk. The companies must have something to gain by delivering the outcomes we incentivise them to deliver. Conversely, by not delivering these outcomes, they will lose out. It is this exposure to both sides of this risk that creates the incentive." (page 7)*

If there is a belief in the value of incentives being strengthened, it is important that the implied regulatory contract can be depended upon. Incentives could be undermined if companies subsequently found themselves being 'penalised' through targets being increased if they are met, due to an unfounded conclusion that the original target was set too low.

Reporting of total leakage does not allow for the two main components of leakage, distribution losses and customers' private supply pipe leakage, to be individually reported.

Customer metering is gaining pace, especially in the South East, with many companies driving towards full metering. In almost all cases, meters are being installed at property boundaries and increasingly smart meters are being used to acquire the consumption data. In time, this will facilitate a far more accurate estimate of both company network distribution leakage and customers' private leakage.

We therefore believe that companies should be required to report leakage from their own distribution assets separately. This is especially important as companies have different policies in dealing with the private customer supply pipe leakage. Reporting of leakage in this way will also improve the reliability of the performance data and will enable UK water companies' performance to be benchmarked against international service providers.

Companies can control how much effort they direct to controlling leakage, but are less able to influence the outcomes. For this reason we believe it is worth considering the reporting of the leakage control inputs as well as the outputs. The inputs could, for instance, be reported as £/property/annum directed at leakage, and the outputs could be reported at Ml/d of leakage, litres/property/day and M3/Km of main/day.

We support the view that current methodologies for setting a sustainable economic level of leakage (SELL) rely on many untested assumptions. They also do not allow for consideration of future efficiencies and can constrain innovation. Customers are thoroughly unimpressed by the current stated SELL levels and are driving for substantial reductions in leakage. When companies start to drive leakage below the SELL in response to customers' views it becomes very difficult to review and retrospectively determine the SELL. This is because the background level of leakage that would be achieved using traditional leakage control methods, which forms a fundamental part of the assessment of the SELL, is not "measurable" after intensive leakage control interventions. In such cases, we recommend that the companies should not be required to reassess their SELL but to merely state the last available SELL assessment.

We support the view that companies should take into account their long-term expectations of the future value of water, the scope for water trading and the resilience of their supplies when considering their leakage commitment levels. Above all, we believe that customers have a crucial part to play in setting future leakage targets.

We also support the view that companies should aspire to, and plan to achieve much more challenging leakage targets in the future and, if a company is not committing to a downward trend in leakage, then it will need to provide robust evidence for why this is the case.

We agree that companies should ensure that their future leakage targets are reflected in their future demand forecasts and that these are consistent with their water resources management plan (WRMP) or explain any differences.

We also agree that companies should set long term aspirational leakage targets in consultation with their customers and in conjunction with other commitments, for instance, long term water resource resilience. This is essential because achieving challenging leakage targets in the future requires a long term commitment which can only be developed as part of a long term strategy.

We are supportive of the proposal that companies should justify why they have adopted a whole company commitment level or regional commitment levels for leakage. As part of the long term leakage reduction strategy, companies should be able to target water stressed areas of their regions more intensively than other areas. In doing so, companies should be able to test new innovative technologies in such areas in the first instance before adoption into their wider network.

We also very much support the view that leakage should be assessed on the basis of at least 3 year rolling average. This is because we see leakage reduction as a long term plan and we expect some ups and downs in the short term due to adverse weather and other factors. The long term trend will determine the success of the long term strategy and this can only be measured by 3 or even 5 year averages.

Q5: What factors should we take into account in our guidance on setting performance levels for bespoke performance commitments at PR19?

We agree with the principles set out previously that companies should use a range of customer insight (e.g. day-to-day information) and valuation information (e.g. WTP studies, revealed preference) to inform both the proposed investment in companies' plans and also the proposed rewards and penalties for companies' proposed ODIs.

We support Ofwat's previously stated view that this evidence should be robust, balanced and proportionate to the scale of investment proposed. We would expect this to be reflected in Ofwat's approach to assessing companies' proposals through the risk based review.

We note that the use of triangulation of valuation methods will require the greater use of qualitative judgment. We believe this is a necessary part of a process that seeks to gain a richer understanding of customers' priorities, and we would expect this qualitative element to be reflected in the forthcoming guidance. We believe that an approach relying purely on prescribing specific mechanistic approaches on benefits and costs could undermine companies' ability to reflect fully their customers' preferences in their business plans.

In order for marginal and incremental costs data to be a useful tool for stakeholders, as with other comparative performance information, the data would need to be collected and presented on a consistent basis.

We are concerned that as marginal and incremental cost data can be based upon a (sometimes limited) numbers of company specific historical schemes, it may be difficult to provide a robust dataset that can be used by stakeholders to make comparisons between companies without detailed prescriptive guidance.

We recommend that should Ofwat be minded to proceed collecting marginal and incremental costs this should be on a specific subset of measures and schemes where it would be possible to assure the quality and consistency of the data provided.

To better understand the regulatory burden of collecting this data imposes upon companies and what benefits it could provide to stakeholder, Ofwat should first consider running a trial collection of data (such as for leakage) before more widespread adoption.

Q6: What is your view on our development of a new customer experience measure for PR19?

We very much welcome the opportunity to provide our view on your proposed development of a new customer experience measure for PR19. As we shape and develop our own services we are fully supportive of the need to look at emerging trends and changing behaviours of our customer base, not as a whole but as individuals.

Customer segmentation will be increasingly relevant as we move towards a truly effective service provision. We will identify ways to develop relevant customer segments, conversing and co-creating with them to establish personalised services which better meet their requirements.
We acknowledge the great need to provide tailored services to those customers in vulnerable circumstances. You may also wish to consider the ways in which companies adapt their services to the fuller broader range and need of their customer base.

For ease we have noted our response to the key questions in your consultation in order:

1. Measured at which level?

Customer effort is a key component of satisfaction and of increasing importance to them. As a measure it may provide insight however there is a danger this could be for a reduced demographic of customer, those who adopt the newer more digital channels, excluding those end users who prefer the more traditional channels.

As an industry we are all acutely aware that our customers benchmark our provision against retailers. Overall satisfaction as a measure has over recent years proven to be a robust and comparable measure and has provided evidence that experience, trust and effort have all been accepted as drivers to an improved satisfaction score. For this reason a qualitative satisfaction measure from a much larger customer base would be our preferred option.

We do not believe that an aggregated rating across a multitude of measures as per the UKCSI will work for the water industry. The current UKCSI adversely affects monopoly industries and the survey questioning directs the consumer to score based on receiving a chosen product or service. This in itself could derive dissatisfaction within our industry at this current time where there is no choice of retailer and the customer does not see the wholesale activity provision as a choice but as a necessity.

2. Wholesale to retail?

We do not agree with that customers easily differentiate between retail and wholesale. This is repeatedly evidenced in the current SIM whereby the contact reason is reallocated due to the customer perception e.g. supply pipe leakage – wholesale or retail, is it the leak or the higher than expected bill?

Companies with a higher meter penetration do, in the main, receive higher call volumes due to the nature of engagement related to metered based charging. These call types are often more difficult to resolve at first contact and as such whilst coming to a satisfactory conclusion are less likely to exceed a customer’s expectation.

Despite this, retaining the 50:50 split is driving improvements and collaborative efforts between retail and wholesale departments for the benefit of our customers as such we believe that this should be retained.

3. Beyond Water?

Cross sector comparisons can provide an indicator on whether the whole sector is losing/gaining pace. Customers however do not perceive a utility bill or service as choice and as such they are unlikely to compare favourably with the retail or non monopolistic markets.

Using an industry average score as a financial reward or penalty measure should be used with caution, as better performing companies could become dis-incentivised with service improvements if they are in effect sharing the benefit of their work with the poorer performing companies.

However using an industry target score (measured or benchmarked against other sectors) as opposed to a flexible target dependent on others performance would give greater clarity on any cost benefit with resulting performance outcome within a company's own control.

4. Beyond contacts and complaints?

We are supportive of any future measure including both outbound and inbound customer contacts.

The inclusion of outbound contacts will strengthen the incentive for companies to continue service improvements and striving to provide a more effortless proactive service to its end users. Furthermore, inclusion of these contacts will ensure companies have the incentive to continue develop and enhance the self serve and digital functionality which continue to be developed across service sectors.

5. A multi channel approach?

We support the exploration of using wider multi-channels for the reasons outlined in the consultation. Our current thinking is that the use of multi-channel is best placed to gauge satisfaction with the contact only.

To drive innovation and adoption of new communication channels the incentive design should incentivise companies allow customers to contact through their favoured channels.

By including the contact in any satisfaction measure, companies will be incentivised to deliver appropriate and well managed new services and be able to adapt to their customers changing behaviour and expectations.

Any new measure will need to carefully consider how close to the point of contact the measure is applied and this could be challenging to measure consistently between channels and across companies.

6. The role of complaints?

We consider complaint receipts can be an indicator of a company's core service offering therefore is likely to continue to have a role in any service measure. The incentive to reduce complaints, and expediently resolve them is driven by the experiential qualitative satisfaction score that customers give.

In our experience the current definition of a complaint does not drive innovative, open or proactive communication channels whilst the quantitative measure remains. To write a complaint a customer must be really dissatisfied with a service. In the new digital age measuring written complaints seems like a step backwards.

Retaining a quantitative element incentivises companies to reduce inbound contact. Arguably this has driven innovation such as proactive contact relating to services. This also captures the broader company performance rather than the qualitative element which captures the views of a sub-set of customers captured by the quarterly SIM survey currently.

7. Incorporate vulnerability?

Identifying and ensuring customers in vulnerable circumstance receive a fair, equitable and supportive service is critical to the future visions and aims of the industry.

Any measurement of this however should be carefully considered to avoid the measurement itself becoming a blocker for the service offerings we want to drive. Measuring how well a company deals with such circumstances could, if appropriate measures are not in place, result in companies choosing to ignore or not seek out those in most need.

8. Beyond end users?

The current WaterUK levels of service measures for services provided to developer customers does not currently capture customers satisfaction with companies' performance.

We welcome the principle of widening of a service measure to include the services provided to developers and retailers. We would however recommend that this is part of a suite of measures and not combined with the household customer element. There are distinctly different service requirements and in order to maintain a service improvement drive within the industry any measure needs to provide meaningful result and insight.

More powerful outcome delivery incentives

Q7: What is your view on the options for increasing the power of reputational and financial ODIs at PR19?

In principle, we agree that ODIs should be made more powerful such that a greater proportion of companies' revenues are dependent on the quality of service they have provided. This ensures that companies' incentives are aligned with the interests of their customers and replicates the forces observable in contested markets.

However, unless ODIs are calibrated well there are risks for customers and companies associated with making them more powerful and real practical considerations which must be addressed. Specifically, we think that we can only move to more powerful ODIs if we are confident about the following:

- The reliability of the performance level reported by an individual company
- The parameters of the ODI: that is, is the performance commitment insufficiently stretching or unduly aggressive? Are the incentive rates correctly calibrated with customers' valuations of service improvement?
- The data and methodologies which underpin the calculation of those ODI parameters: has the industry dataset from which performance commitments been selected been compiled on a consistent basis? Are willingness-to-pay estimates sufficiently robust to support the customer valuations?

We suggest that in most areas there is more work to be done before all these tests are passed and we could safely move to increasing the power of ODIs.

We support the principle of more powerful ODIs including through a higher overall range for ODI rewards and penalties and an increase in the proportion of ODIs with financial rewards based on stretching performance targets.

With this proposed shift to companies earning a higher proportion of their returns through ODIs for delivering high quality service to customer it is important that these incentives, once committed through Final Determinations are applied using a certain, transparent, and mechanistic regulatory process. Failure to do this would introduce undue uncertainty. Within this consultation Ofwat recognise the benefits of a mechanistic approach, stating that this is more transparent for companies, customers, other local stakeholders and regulators.

It is important that there is no additional, unnecessary uncertainty associated with the transition to higher rewards and penalties for ODIs otherwise this will affect investors' perception of the risk profile of companies which could increase the required returns recoverable through the weighted average cost of capital and so disbenefit customers.

As a general point, we think it is important that the outcomes framework enables companies to apply variants at their own discretion (e.g. the choice of in-period ODIs and revenue or RCV backed ODIs) in collaboration with their customers and CCGs in developing the optimal balance. On this basis we advise against over-prescription. This is consistent with companies drawing of wider sets of information relating to their specific customers' preferences when setting outcomes.

In the remainder of our response to this question; we draw out some specific comments on areas highlighted in the consultation.

Range for ODI rewards and penalties

We would support a higher overall range for ODI rewards and penalties. We also believe that the range should be symmetric between penalty and reward. We agree that the ODI framework including rewards and penalties has increased companies' focus on delivering what their customers want and that there is likely to be scope for this to be increased with stronger incentives.

Aggregate cap and collar

Subject to assurances on the mechanistic application of ODI rewards and penalties, we would support the removal or widening of the aggregate cap and collar on ODIs.

RCV-linked ODIs

Although we did not include any ODIs linked to RCV at PR14, we think that it is important that companies retain the flexibility to include ODIs linked to RCV for those ODIs that deliver benefits to customers over a long period (such as those linked to behavioural changes) and for schemes which cover more than one price review period. It is also important that a link is maintained between the customers whose are impacted by an ODI and the customers who pay for an ODI reward or receive a reduction in bill due to an ODI penalty.

Alternative approaches to setting ODI rewards and penalties
We support the use of alternative approaches to setting ODI rewards and penalties. Instead of a overly prescriptive bottom-up approach or imposition of a top down approach, companies should have the flexibility to choose the most appropriate approach that makes use of all available information, this could include the use of a top-down approach that has been informed by bottom-up formulas.

Industry standard ODIs
We would not support the adoption of industry-standard ODIs for the common performance commitments as this would override the role of customer engagement and customer valuations.

Use of deadbands
The appropriate range and use of deadbands is dependent upon a number of factors such as the scale of performance that is driven by factors outside companies controls (such as weather). As these factors will be different for each ODI the appropriate range and use of deadbands will be dependent upon the particular characteristic of each individual ODI, companies should have the flexibility to select the most appropriate ODI design based upon robust evidence.

Equity Menus
As outlined in our response to the cost of debt consultation and our paper on menus in the market place for ideas[4] , we feel that menus are overly complex regulatory tools that are generally ineffective so we would not support the introduction of a cost of equity menu.

Gated ODIs
Our initial view on gated ODIs is that they could potential dilute the incentive properties of some measures and would introduce unnecessary complications and potential incidence effects.

Better reflecting resilience outcomes

Q8: What is your view on our proposals for better reflecting resilience within the outcomes framework?

We welcome the proposal to reflect resilience more clearly within the outcomes framework. It is important for the industry to prepare for future challenges so that services for future customers and the environment can be safeguarded.

We welcome resilience being better reflected in the common performance commitments and ODIs and support the development of common resilience measures. Resilience is a multi-faceted topic so to allow meaningful comparisons between companies and over time, we believe more than one

4 http://www.anglianwater.co.uk/_assets/media/Future_use_of_menus_as_part_of_price_setting_methodology_-_Final.pdf

measure may be needed. We are actively engaged in developing resilience metrics, through WaterUK and the Water and Wastewater Resilience Action Group (WWRAG), and with the National Infrastructure Commission on their work on performance measures and believe that the outcome of this work should be considered by Ofwat as it considers responses to this consultation.

Whatever measures are chosen, however, it is imperative that they are designed based on assessment of the future risk, and thus on a forward-looking basis, rather than against historic performance.

Q9: What is your view on the options and our preferred approach to asset health outcomes?

With one exception, we agree with all of the proposals in box 3 on page 24 of the consultation to improve the information stakeholders have on asset health incentives. Our one exception is the proposal that companies should submit their definitions and mechanisms ahead of business plans. We do not understand the rationale for this and none is provided in the document. In contrast with the arrangements at PR14, we think the PR19 plan provides ample opportunity for asset health ODIs to be challenged and scrutinised in the same timetable as the rest of the business plan.

We agree with all of the proposals in box 4 on page 25 of the consultation to improve transparency about asset health performance commitments.

Without having studied companies' AMP6 asset health ODIs in detail, we suspect there is already a high degree of standardisation across them. We are not persuaded of the merits of moving to a greater degree of standardisation.

We agree that the majority of effort in asset health is about maintaining stability rather than making large improvements. In this scenario, penalty-only ODIs feel appropriate. We agree that rewards might be appropriate in the situation where a company has agreed to improve its asset health and achieves its goals ahead of schedule.

Making performance commitments more transparent to customers

Q10: To what extent do you agree with our proposals for making performance commitments more transparent for customers?

We wholeheartedly support the proposals for making performance commitment more transparent for customers. We would also support any move to make the overall outcomes frameworks clear and transparent for customers and other stakeholders. As mentioned before, for this to deliver trust and confidence for customers, consistent data and definitions need to be ensured.