

November 2016

Trust in water

# **A consultation on the outcomes framework for PR19**

## **Appendix 1 – Making performance commitments more stretching**

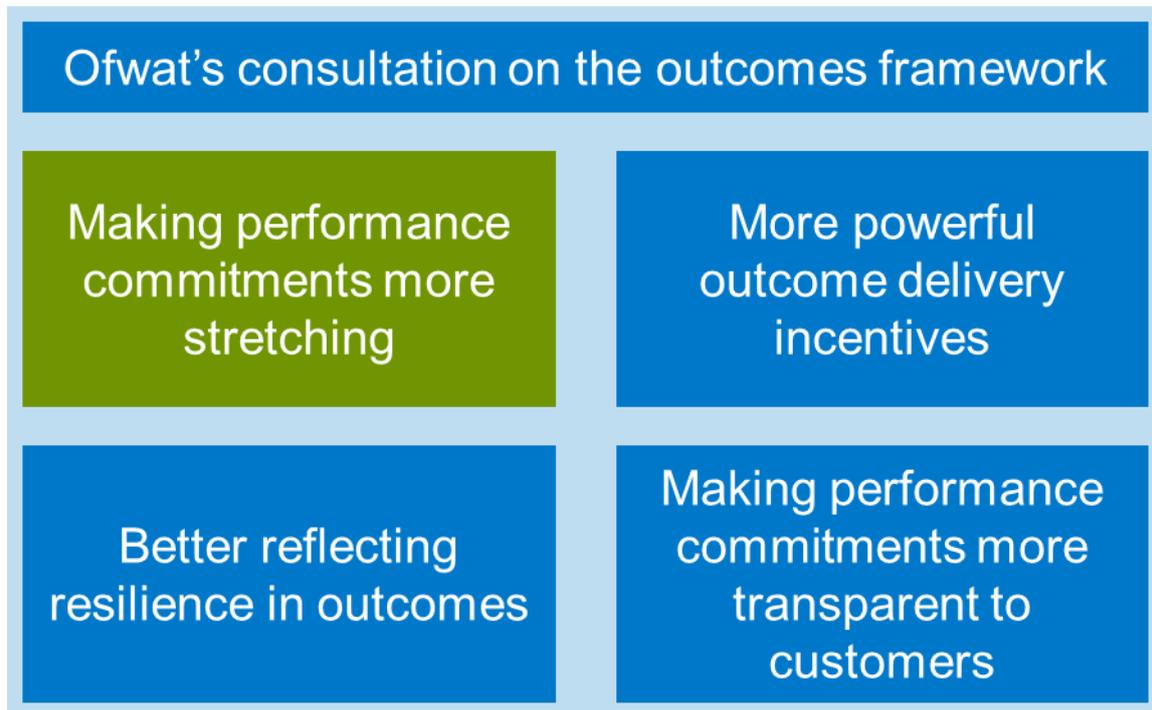
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## Appendix 1 – Making performance commitments more stretching

This is appendix 1 to the consultation on the outcomes framework for PR19. In this appendix we consider how performance commitments can be made more stretching for PR19.

**Figure 1 –Appendix 1 relates to the first theme of the outcomes consultation**



We want to create the right incentives for companies to deliver excellence in the services their customers want. We want to encourage companies to reach new frontiers in outcome delivery, so that customers, other stakeholders and we can use this information to challenge all companies to deliver better quality services over time.

Performance commitments play a key role in encouraging the sector to deliver excellence in services. They are the pledges that companies make to their customers and other stakeholders about their service levels in order to secure the desired outcomes. They are at the heart of a customer-driven service by regulated companies.

## **Structure of this appendix**

Appendix 1 consists of five sections.

1. Making performance commitments more stretching using improved information, including comparative information.
2. Making performance commitments more stretching through common performance commitments.
3. Setting stretching commitment levels for the common performance commitments.
4. Making leakage performance commitment levels more stretching.
5. Other ways to make performance commitments more stretching.

There is a separate appendix, appendix 5, on a new customer experience measure which considers how such a measure could be made more stretching than the current service incentive mechanism (SIM).

# 1 Making performance commitments more stretching using improved information, including comparative information

We are proposing improvements to the information available to customers and CCGs to give them more tools with which to challenge their companies during the engagement and assurance process for PR19.

**Table 1.1 – our proposal on improved information**

Proposal on improved information	Status
1. We propose to assess companies' provision and use of information as part of our risk based review (RBR) tests at PR19.	We are inviting early views on this issue. We expect to consult on our risk based review tests in the July 2017 methodology consultation.

## 1.1 Introduction

Companies' outcomes are supported by performance commitments which allow customers to monitor companies' progress towards their outcomes. Key in setting appropriately stretching performance commitments is extensive engagement and a strong level of challenge from customers, so that companies have a good understanding of what baseline performance customers expect, but also what customers consider excellent performance would look like. CCGs play an important role by challenging how companies have engaged with their customers and how they have reflected customer views in their performance commitments.

Comparative performance information on the services that water and wastewater companies provide is extremely valuable in providing context and transparency about companies' relative performance across the sector. The wider availability and use of comparative information should provide richer information for customers and CCGs when engaging with their companies on performance commitments. The additional information provides a tool for customers and CCGs to use to challenge their companies to set truly stretching performance commitments.

Information on the cost of capital, ranges for ODI rewards and penalties and wholesale cost assessment approach will also provide more information with which customers and CCGs can challenge their companies during the engagement process.

In this chapter we discuss how the information available to customers, CCGs and other stakeholders can be improved and how we can incentivise companies to use that information in their customer engagement processes.

## **1.2 Comparative performance information**

During PR14 companies engaged with their customers and CCGs on outcomes and performance commitments with relatively little visibility of other companies' performance, although there were variations between companies. In reflecting on PR14 we considered that making comparative performance information more easily available would have given customers and CCGs a tool with which to challenge companies, and could have reduced the need for us to intervene in company business plans at the price review.

In December 2015 we consulted on the role that comparative performance information could play at PR19. Respondents generally welcomed the provision of comparative information on company performance, but highlighted that the measures need to be truly comparable and the definitions must be clear. In our May 2016 decision document and customer engagement policy statement we identified the effective use of comparative performance information, with definitions that are consistent across the sector, as one of our principles for good quality customer engagement. We stated that we expect CCGs' independent reports to us at PR19 to cover how effectively the company has engaged with its customers on its performance compared with other companies in a way that customers can understand.

We acknowledge that comparative performance information might need context in order to be effective. It will be up to companies to appropriately frame such information and ensure customers understand any reasons or justifications underpinning performance on a particular comparative measure. At the same time, we do not want companies to explain away differences that reflect genuine underlying inefficiencies or performance challenges. We expect companies to frame comparative performance information appropriately. CCGs will have an important role challenging companies and providing assurance to us that companies have made appropriate use of comparative performance information when engaging with their customers.

The increased use of comparative information will still leave plenty of scope for companies to engage with and understand their customers' particular preferences and to propose bespoke performance commitments that reflect them.

### 1.3 Making comparative performance information accessible and comparable

For comparative information to be useful in driving more stretching performance commitments, the information needs to be easy to access, presented in a way that customers can understand, and genuinely comparable.

While a lot of information on water sector performance exists in publications by different organisations, it has not been collected together and made easily accessible to customers and CCGs up to now. Following extensive work through a joint effort led by Water UK<sup>1</sup> phase 2 of the information dashboard called ‘Discover Water’ has just been launched. Discover Water aims to provide a strategic overview of what really matters to customers and society, have robust, clearly-sourced data which allows comparisons to be made between companies, and be interactive and enable stakeholders to have access to information to use how they wish.

Discover Water can provide a lot of the information that customers, and CCGs will need to engage effectively with companies on their proposed performance commitments for PR19. Discover Water includes 13 of the 16 customer-focussed comparative measures<sup>2</sup> we discussed with stakeholders at a workshop in June 2016 and goes beyond these to include comparative information on 24 measures listed in the table below. The plan is for Discover Water to develop further over time.

**Table 1.2 Comparative information measures available in Discover Water**

Comparative information measures in Discover Water		
Drinking water quality	Water consumption***	Contacts about the appearance of water
Taste/odour contacts	Leakage	Properties below the reference pressure level
Water supply interruptions	Total pipe bursts	Average bill***
Quality of service (SIM)	Complaints handled by CCWater	Written complaints received by companies
Greenhouse gas emissions**	Internal sewer flooding	External sewer flooding

<sup>1</sup> The development of Discover Water involved Water UK, the water and wastewater companies, Ofwat, CCWater, the Welsh Government, Defra, the Environment Agency, Natural Resources Wales and the Drinking Water Inspectorate.

<sup>2</sup> The 16 comparative measures were: water quality compliance; water quality contacts; supply interruptions; internal sewer flooding; pollution incidents; SIM; environmental compliance (numeric); water efficiency (PCC); leakage; greenhouse gases; external sewer flooding; mains bursts; customer satisfaction; value for money; river water improvements; and environmental obligations. Rivers enhanced (km), customer satisfaction and value for money are included in Discover Water at an industry level for customer information rather than as a comparative performance measure as it is difficult to make comparisons between companies using the available information.

Comparative information measures in Discover Water		
Environmental Performance Assessment	Environment improvements complete	Pollution incidents
Wastewater and water permit compliance		

\*\*\* 3 measures

\*\* 2 measures

Discover Water uses information from existing sources and relies on the comparability of data from those sources. Companies have been working on the comparability of data of some of the key measures used in Discover Water (leakage, supply interruptions and sewer flooding). This work will not impact on PR14 performance commitments and ODIs, but will inform the development of PR19 performance commitments and ODIs. We and other sector stakeholders will be involved in the next stage, a review and challenge of the work done to date, commissioned independently by UKWIR to provide assurance of the definitions.

Discover Water is not the only source of comparative information available. We expect companies to supplement the Discover Water dashboard with other sources of comparative information where this is appropriate. This might include information from CCWater's ['Delving Into Water'](#) report and other regulatory reports.

We provide comparative information on company performance in publications such as our ['Monitoring financial resilience report'](#). We do not plan to provide customers and CCGs with further comparative information, unless it is evident that the available comparative information, or the consistency of the measures, is insufficient.

## 1.4 Other information

We will provide information on the cost of capital, ranges for ODI rewards and penalties and wholesale cost assessment approach in advance of companies' submitting their business plans. This will provide more information with which customers and CCGs can challenge their companies during the engagement process.

## 1.5 Incentivising the better use of information in business planning

We expect companies to think creatively about how they use comparative performance information and other information, such as on the cost of capital, to

engage with their customers and stakeholders. Companies are best placed to decide on the approach they take but we think there are opportunities to use information to:

- inform and educate customers;
- improve customer research;
- gather views on future performance levels;
- explain legitimate differences in performance;
- justify decision making; and
- help to involve customers in service delivery.

There are at least two incentives for companies to use information effectively:

- The effective use of comparative information, with definitions that are consistent across the sector, is one of our principles for good quality customer engagement. We will be assessing companies' business plans against our principles for good quality customer engagement at PR19 during our risk-based review.
- We expect CCGs' independent reports to us at PR19 to cover how effectively the company has engaged with its customers on its performance compared with other companies in a way that customers could be expected to understand. A company has an incentive to engage effectively so that the CCG provides a positive view of its engagement in its report.

These incentives allow companies to use information, including comparative performance information, in their engagement with customers in the way that is most appropriate to their local circumstances. This fits with our regulatory approach and avoids us prescribing how the information should be used (which will vary by company and issue).

We considered whether we should specifically test companies in the PR19 risk-based review on their use of the 16 comparative measures we discussed with stakeholders during our workshop in June 2016. We identified these 16 comparative measures as being particularly important to customers based on the results of companies' engagement with customers at PR14, an UKWIR project on benchmarking measures and the views of our stakeholders. However, we are content that Discover Water includes these measures where appropriate and that we are able to take account of the quality of the companies' engagement on comparative data. We conclude that specific tests for the 16 comparative measures are not desirable as they might constrain companies' use of other information which might be more appropriate in the specific contexts of their customer engagement.

**Consultation question on using improved information to make performance commitments more stretching**

**Q1:** What is your view on the use of improved information, including comparative performance information, at PR19 to make performance commitments more stretching?

## 2 Making performance commitments more stretching through common performance commitments

**Table 2.1 - Our proposals on common performance commitments**

Proposal on common performance commitments	Status
<p>1. We are consulting on a list of ten common performance commitments which we propose all companies will use based on standard definitions.</p>	<p>We are inviting views on our proposed ten common performance commitments. We expect to set out our decision on the common performance commitments alongside the methodology consultation. We propose to consult on the definitions of the common performance commitments in the methodology consultation.</p>
<p>2. We consider whether the common performance commitments should have in-period ODIs attached to them or whether this should be a decision for a company following engagement with its customers.</p>	<p>We are inviting views on whether the common performance commitments should have in-period ODIs attached to them. We expect to set out our decision alongside the methodology consultation.</p>
<p>3. We are seeking views on whether there are particular areas that all companies should cover with their bespoke performance commitments, but without requiring a common performance commitment. An example might be performance commitments related to customers in circumstances which might make them vulnerable.</p>	<p>We are inviting early views on areas companies should cover with their bespoke performance commitments. We expect to consult on a preferred approach in the methodology consultation.</p>
<p>4. We invite views on whether companies must propose performance commitments and ODIs that relate to each price control and whether they must be specific to each price control.</p>	<p>We are inviting early views on whether companies must propose performance commitments and ODIs that relate to each price control and whether they must be specific to each price control. We expect to consult on a preferred approach in the methodology consultation.</p>

### 2.1 Introduction

Common performance commitments allow us to compare the ambition of companies' proposals and, if needed, to set stretching performance commitment levels for poorer performing companies which benefit the customers of those companies.

The philosophy of outcomes is that performance commitments and ODIs are developed by companies through local engagement, so that they reflect the priorities of their customers and other stakeholders. However, some issues are of high importance to customers across England and Wales and there is a case for having common performance commitments (with ODIs, potentially in-period ODIs) that all companies must include in their business plans at PR19. The use of common performance commitments at PR14 reflected companies independently consulting with their customers on their priorities and inadvertently converging on a set of common performance commitments.

Companies will still have plenty of scope to propose their own bespoke performance commitments based on local customer engagement alongside the common performance commitments.

## **2.2 The common performance commitments at PR14**

At PR14 there were effectively seven common performance commitments:

- two specified in the 2013 methodology statement for PR14 – SIM and leakage; and
- five introduced at draft determinations (based on almost universal coverage across the sector) - supply interruptions, water quality compliance, water quality contacts, pollution incidents and internal sewer flooding.

Our PR14 methodology also specified that the abstraction incentive mechanism (AIM) would be a common performance commitment. However, due to the difficulties in obtaining good quality information to underpin the AIM in time for PR14 we did not require it as a common performance commitment, although five companies did adopt it as a bespoke performance commitment. A company-run AIM taskforce helped us develop the AIM with other organisations so that it became a reputational incentive that we strongly encouraged 13 companies<sup>3</sup> to adopt from 1 April 2016.

## **2.3 The case for common performance commitments**

Common performance commitments allow us to compare the ambition of companies' proposals and, if needed, to set stretching performance commitment levels for poorer performing companies which benefit the customers of those companies. At PR14 several stakeholders, including some companies, were concerned that some

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<sup>3</sup> The Environment Agency data on which we based the AIM suggested the environmental and abstraction situations for 4 of the 17 companies did not warrant the application of the AIM.

companies had commitment levels for the same or similar performance commitments which were much less stretching than others. In some cases one company could be delivering the same service performance as another company, but incurring a penalty for its performance whereas the other company would obtain a reward. The use of common performance commitments enabled us to ensure all companies had stretching commitment levels for a small number of key measures to the benefit of their customers.

Common performance commitments ensure all companies have performance commitments for those issues which matter most to customers across England and Wales. The PR14 common performance commitments covered issues of paramount importance to customers such as water quality and reducing internal sewer flooding. Most companies had already included the common performance commitments in their business plans following extensive engagement with their customers on what their priority issues were.

We will still expect companies to engage with their customers on the common performance commitments as this might reveal useful information to inform our possible setting of common commitment levels and common ODIs for the common performance commitments. The engagement can also check that the common performance commitments we have identified on the basis of the customer engagement for PR14 remain important to customers.

## **2.4 Stakeholders' views**

We held a stakeholder workshop on outcomes on 14 June with external attendees from companies, CCGs, other regulators and government. Some stakeholders questioned whether common performance commitments were strictly necessary. Others considered that the common performance commitments should be designed to enhance, not displace, the customer engagement and innovation that was introduced at PR14. Some welcomed common performance commitments as helping customers and CCGs to compare performance across companies more easily.

There were some stakeholders who thought common performance commitments should better reflect what customers really care about e.g. the intensity of sewer flooding events and how effectively companies respond rather than just the number of incidents. There were also some concerns about using “traditional” measures for the common performance commitments as these might not help promote innovation, although innovation could still happen through the bespoke performance commitments. Attendees asked for the common performance commitments to be

meaningful, non-technical and easy to understand for customers. There was also a call for the common performance commitments to cover resilience.

## 2.5 Proposed common performance commitments for PR19

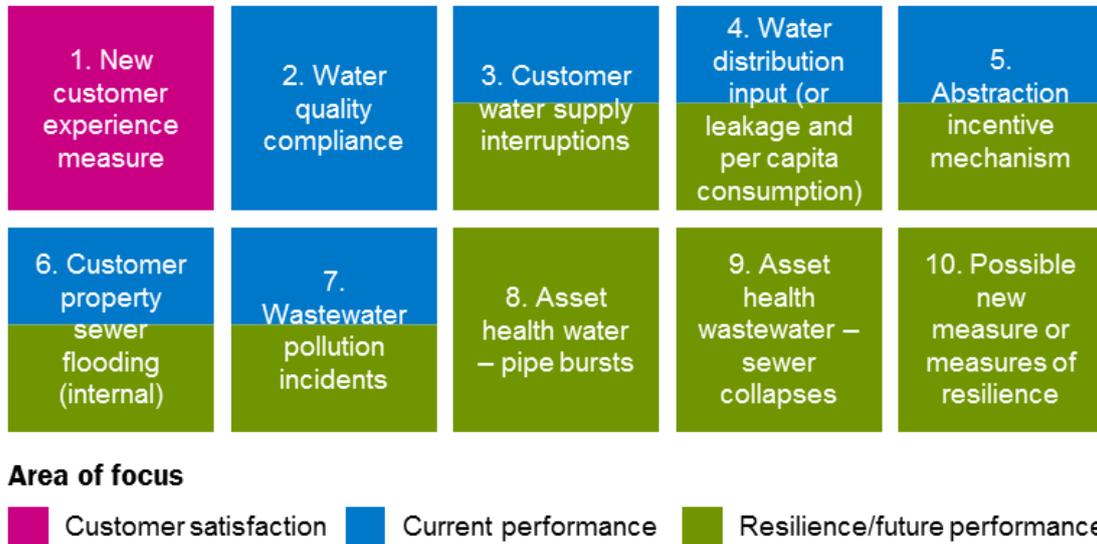
Reflecting stakeholders' views, the lessons learned from PR14 and considering from first principles the need for common performance commitments we have developed a set of principles for common performance commitments for PR19:

1. There should be a **relatively small number** of common performance commitments to ensure companies retain ownership of their business plans;
2. There should be good **coverage** of the outcomes that matter to **customers** and / or are relevant to **resilience** outcomes;
3. There should be **minimal overlap** between the common performance commitments;
4. The common performance commitments should use **consistent definitions**; and
5. The common performance commitments should reflect the needs and requirements of **future** customers.

By applying the above principles we are identified ten possible common performance commitments to consult on for PR19:

1. Future customer experience measure;
2. Water quality compliance;
3. Customer water supply interruptions;
4. Water distribution input / leakage / per capita consumption;
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); and
10. Possible new common measure or measures of resilience.

**Figure 2.1 – proposed common performance commitments for PR19**



We explain our views on why these ten measures are appropriate to be common performance commitments at PR19 in the table below. We consider that there is a strong case for these ten common performance commitments. We invite views on whether these commitments cover the right areas, are the appropriate measures for each area and whether ten is the appropriate number of common performance commitments.

For the fourth common performance commitment we welcome views on whether distribution input should be used as the common performance commitment for the efficient use of water, instead of leakage or per capita consumption, as it is a broader measure of water demand. If we used both leakage and per capita consumption, that would increase the number of common performance commitments to eleven across water and wastewater.

**Table 2.2 – possible common performance commitments at PR19**

One key difference between the common performance commitments at PR14 and those we are proposing for PR19 is that the PR19 common performance commitments will be based on common definitions which all companies will have to use. This will enable easier comparisons between companies’ performance on many of the common performance commitments and the setting of common commitment levels for the performance commitments, where appropriate, which we discuss in the next section.

We explain in the fourth column the status of the definition. We plan to confirm our common performance commitments in the methodology consultation and consult on the definitions of the common performance commitments at that time. We consider that getting the definitions right is central to better reflecting resilience and what matters to customers in the definitions.

<b>No.</b>	<b>Proposed common performance commitment for PR19</b>	<b>Reasons why it should be a common performance commitment at PR19</b>	<b>Status of definition</b>
1	Future customer experience measure	Customer service is integral to the full breadth of services which water and wastewater companies provide. On both the wholesale and retail side, it affects all customers who interact in some way with companies. Strong stakeholder support.	We are currently working on a new customer experience measure. More details can be found in appendix 5.
2	Water quality	Water safety and quality are a top customer priority. We will work with the DWI and the sector to identify the best available measure of water quality for PR19.	For PR14 we had common performance commitments for mean zonal compliance and water quality contacts. We are proposing to have only one water quality measure in PR19. There are several candidates for the measure: mean zonal compliance; water quality contacts or water

No.	Proposed common performance commitment for PR19	Reasons why it should be a common performance commitment at PR19	Status of definition
			<p>quality incidents. All of these measures, with appropriate normalisation, are included in Discover Water.</p> <p>We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.</p>
3	Supply interruptions	<p>Customers view long interruptions to supply as one of the worst failures in service.</p> <p>Supply interruptions are an indicator of the resilience of the water network, in particular how well a company can recover from an incident.</p>	<p>Our starting position is to use supply interruptions greater than 3 hours, which most companies have for their PR14 performance commitment and which is included in Discover Water.</p> <p>We welcome the efforts by water companies to improve the definition of supply interruptions for use from 2020 onwards. We understand that a working group is aiming to finalise a definition by the end of March 2017 to allow for shadow reporting from 2017-18 onwards. We will engage with the working group on this definition and whether it should be used for the common performance commitment.</p> <p>We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.</p>
4a	Distribution input	Measures trends in water demand and indicates the effectiveness of all water demand activities such as those for water efficiency and leakage.	Companies report distribution input as part of the water resource planning process and we could use

No.	Proposed common performance commitment for PR19	Reasons why it should be a common performance commitment at PR19	Status of definition
		Total water demand is a measure of the resilience of the sector.	this definition, subject to stakeholders' views on its comparability. We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.
4b	Leakage	Leakage is a significant issue for customers. Leakage is an indicator of the resilience of the water network.	We welcome the efforts by water companies to improve the definition of leakage for use from 2020 onwards. We understand that a working group is aiming to finalise a definition by the end of March 2017 to allow for shadow reporting from 2017-18 onwards. We will engage with the working group on the definition and whether it should be used for the common performance commitment. We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.
4c	Per capita consumption	Per capita consumption is a direct measure of customer demand. It is an indicator of resilience and the success of measures to reduce or limit demand.	Per capita consumption is included in Discover Water and we could use this definition. We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.
5	Abstraction incentive mechanism	Reducing abstraction from environmentally-sensitive abstraction sites is a priority for some water sector stakeholders.	We propose to start from the existing abstraction incentive mechanism. We will need to work with the AIM taskforce and all companies covered by the AIM

<b>No.</b>	<b>Proposed common performance commitment for PR19</b>	<b>Reasons why it should be a common performance commitment at PR19</b>	<b>Status of definition</b>
	(Might only apply to a subset of water companies)		to define the abstraction sites that will be covered by the AIM from 2020 onwards.
6	Internal sewer flooding (Applies to sewerage companies only)	Internal sewer flooding is one of the most distressing service failures for customers and reducing it is a customer priority. It is an indicator of sewerage network resilience.	We welcome the efforts by water companies to improve the definition of internal sewer flooding for use from 2020 onwards. We understand that a working group is aiming to finalise a definition by the end of March 2017 to allow for shadow reporting from 2017-18 onwards. The measure will need to be normalised for the number of connections. We will engage with the working group on the definition and whether it should be used for the common performance commitment. We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.
7	Pollution incidents (Applies to sewerage companies only)	Pollution incidents is an indicator of sewerage network resilience. Reducing pollution incidents is important for customers and several key stakeholders. Pollution incidents is one of the best existing indicators of environmental impacts.	As a starting point we propose to use the definition of pollution incidents included in Discover Water (Category 1, 2 and 3 pollution incidents). We will work with the Environment Agency and the sector to see whether any improvements need to be made to the definition for PR19. The measure will need to be normalised by total length of sewers.

No.	Proposed common performance commitment for PR19	Reasons why it should be a common performance commitment at PR19	Status of definition
			We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.
8	Water mains bursts (asset health water)	<p>The resilience of the water network is a priority for the UK and Welsh governments and many of our stakeholders.</p> <p>The underlying health of water network assets is needed to deliver water services for current and future customers.</p>	<p>As a starting point we propose to use the definition of mains bursts included in Discover Water. The measure will need to be normalised by length of mains.</p> <p>We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.</p>
9	Sewer collapses (asset health wastewater)	<p>The resilience of the wastewater network is a priority for the UK and Welsh governments and many of our stakeholders.</p> <p>The underlying health of the wastewater network assets is needed to deliver wastewater services for current and future customers.</p>	<p>At PR14 nine of the ten water and sewerage companies had a performance commitment or a sub-measure to a performance commitment on sewer collapses. Our starting point would be to use the annual number of sewer collapses normalised for total length of sewers.</p> <p>We invite views from stakeholders now and we will consult on our proposed definition in the methodology consultation.</p>
10	Possible new common measure(s) of resilience	There is strong support from the UK and Welsh governments, the Resilience Task and Finish group, companies, CCG chairs and other stakeholders for going beyond business-as-usual	There are several current initiatives to develop resilience metrics (see main document and appendix 3).

<b>No.</b>	<b>Proposed common performance commitment for PR19</b>	<b>Reasons why it should be a common performance commitment at PR19</b>	<b>Status of definition</b>
		measures of resilience and develop a new measure(s).	We will review the sector's work and determine what resilience metric or metrics should be included for consultation in the PR19 methodology consultation.

## **2.6 In-period ODIs for the common performance commitments**

We will expect the common performance commitments to have ODIs attached to them. In appendix 2 we discuss the merits of in-period and end-of-period ODIs i.e. those ODIs applied before the following price review and those applied at the following price review. We consider that the choice of in-period ODIs should be up to companies following engagement with their customers and challenge from their CCGs. We will review companies' customer engagement on in-period ODIs as part of the price review and we will intervene if necessary to protect customers.

If we require companies to have common performance commitments we need to consider whether we should also require companies to take a consistent approach to the application of in-period ODIs. A consistent approach to in-period ODIs would ensure that companies had similar incentives to achieve their common performance commitments. However, different companies' customers might have different views on in-period ODIs for common performance commitments and applying a consistent approach to in-period ODIs might not reflect their views fully.

We are asking for views on whether we should require, encourage or leave up to companies, following engagement with their customers, to decide if the common performance commitments should have in-period ODIs attached to them. We expect to set out our decision alongside the methodology consultation.

## **2.7 Coverage of performance commitments**

At PR14 the choice of outcomes and associated performance commitments was developed by water companies through customer engagement, with CCGs playing a key role in assuring the engagement. There were no restrictions on the number or type of outcomes or performance commitments that companies could include in their business plans. In total, companies identified over 120 outcomes and 527 performance commitments<sup>4</sup>, covering all aspects of service delivery. Nevertheless, in a few instances we intervened to ask companies to include performance commitments in specific areas such as environmental compliance where we considered a company had not supported an outcome that matters to customers. For PR19 we want to see companies ensuring that all their outcomes are appropriately supported by performance commitments. We also expect companies' outcomes to cover all the issues that matter to their customers.

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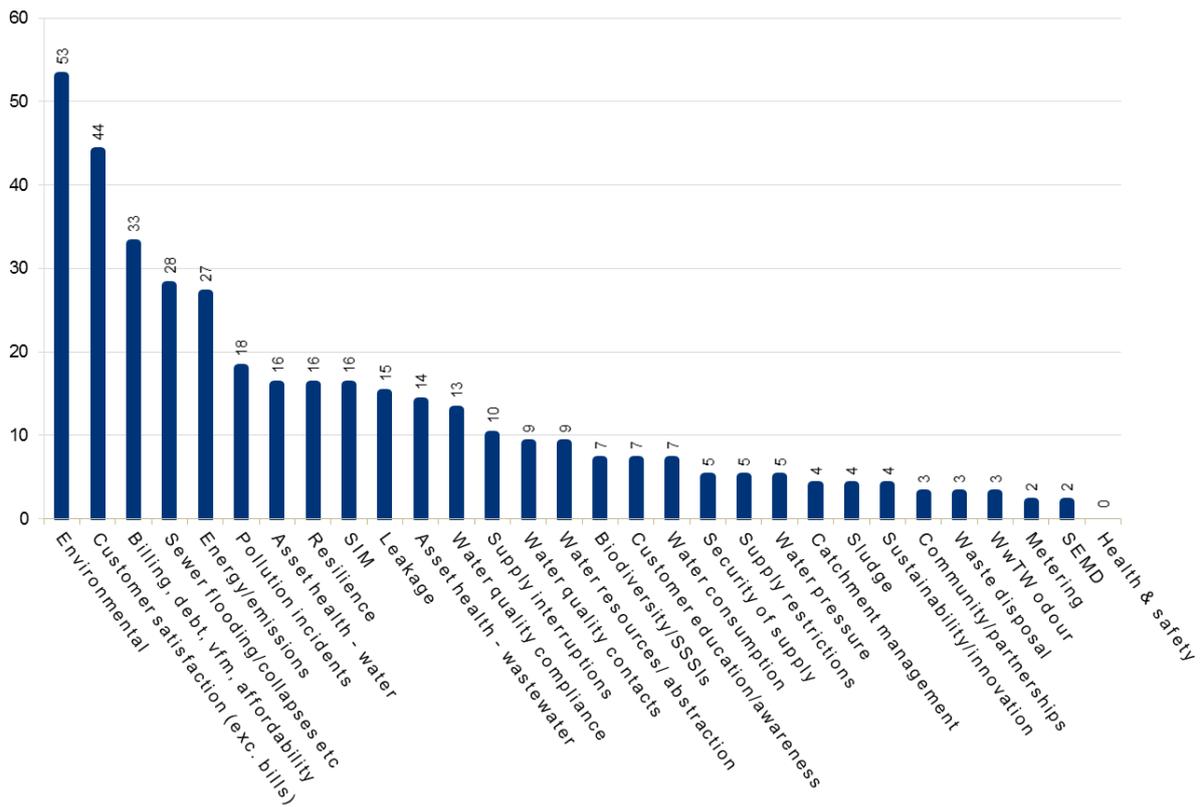
<sup>4</sup> A further 171 sub-measures lay beneath the 527 performance commitments.

### 2.7.1 The coverage of performance commitments at PR14

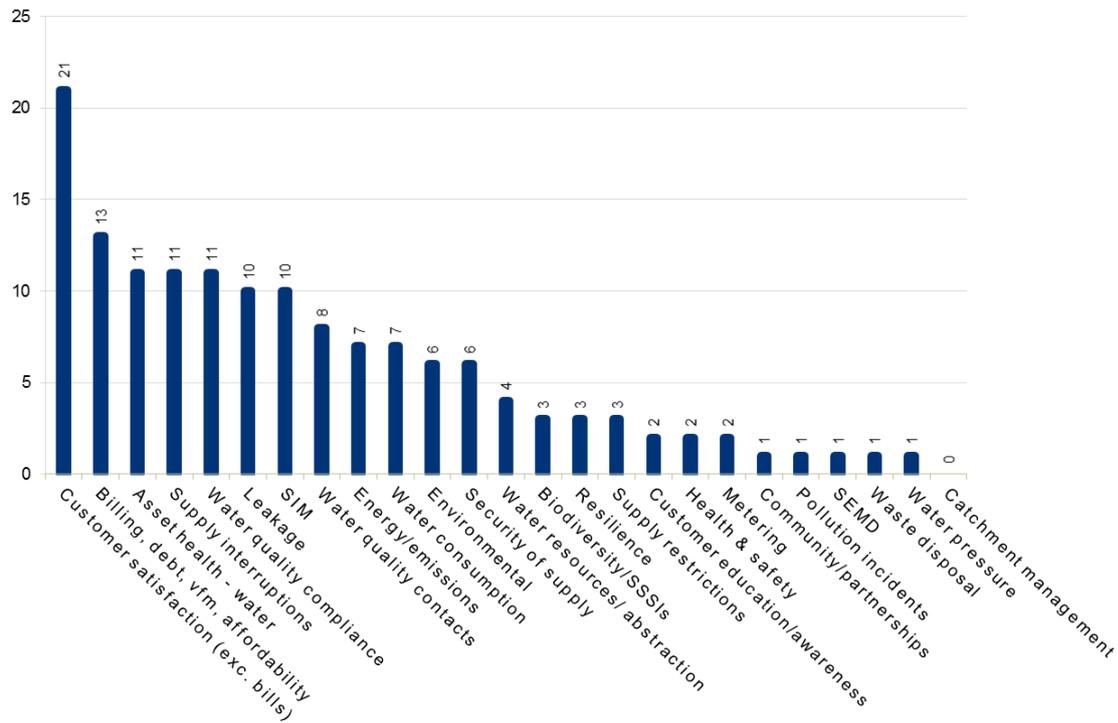
Figures 1 and 2 provide an overview of the number and type of performance commitments included in company business plans at PR14. The information shows that different areas of service have different numbers of performance commitments associated with them. There are a number of reasons for this variability, not least the different services that companies provide and local customer preferences.

The most frequent performance commitments within water and sewerage companies' business plans were those relating to environmental and customer satisfaction commitments. For water-only companies they were customer satisfaction, billing, debt and affordability.

**Figure 2.2 - performance commitments within water and sewerage company PR14 business plans**



**Figure 2.3 - performance commitments within water only company PR14 business plans**



### 2.7.2 Coverage of performance commitments at PR19

For PR19 we expect there to be appropriate performance commitment and ODI coverage of the areas of service that matter most to customers. We will be looking for companies to develop the right balance of performance commitments and ODIs across their services. The evidence from PR14 shows that there was good coverage, but we are seeking views on whether there are particular areas that all companies should cover with their outcomes, performance commitments and ODIs.

An example of an area that we would like to see companies focussing more on is customers whose circumstances make them vulnerable. Many companies already have performance commitments that relate to water customers whose circumstances make them vulnerable, for example, performance commitments measuring the take up of social tariffs in their region.

Our [Vulnerability Focus Report](#) found that the sector still has a long way to go to meet customers' needs. In that report we challenged companies to understand the circumstances of their customers and better tailor their support. Developing performance commitments and ODIs in relation to vulnerability is one way in which companies can rise to this challenge. We are also discussing including vulnerability

in our new customer experience measure in appendix 5. If vulnerability is included in the new measure companies would need to take this into account when developing any bespoke performance commitments and ODIs relating to the issue.

We are also seeking views on whether, for the areas that all companies should cover with their outcomes, performance commitments and ODIs, we should require companies to report against common metrics. This is because customers and stakeholders are likely to want to compare performance in these important areas. The common metrics would be in addition to companies' bespoke performance commitments.

### **2.7.3 Coverage across price controls**

One of the innovations at PR19 will be new price controls for water resources and bioresources, reflecting the potential development of new markets in these areas. We will consult on our approach to these new price controls in more detail in our methodology consultation. The potential development of new markets and the introduction of separate price controls raises the question of how performance commitments and ODIs should relate to them. We are also introducing direct procurement for customers at PR19 and we consider the implications of this for performance commitments and ODIs in appendix 4.

The nature of these new markets also affects how the performance commitments and ODIs should relate to them. For bioresources the market consists of wholesalers contracting out or providing bioresources services to other wholesalers. For water resources, retailers in company areas wholly or mainly in England will be able to choose their water resource provider, but the timing of this depends on when Water Act 2014 provisions are commenced. Even when those provisions are commenced, only business retailers (unless the UK government decides to open the residential retail market) will be allowed to choose water resource providers.

Potential approaches to performance commitments and ODIs could be:

- no performance commitments or ODIs related to areas where competition for the provision of water resources or bioresources services could exist, to ensure a level playing field between participants;
- Price-control-specific performance commitments and ODIs that directly reflect what customers value in these areas; or
- non-price-control-specific performance commitments and ODIs that place incentives on companies with respect to the services that matter to customers, possibly with other incentives to encourage companies to manage their activities

in new markets in a manner that is consistent with delivering that quality of service.

For PR14 we linked the performance commitments and ODIs to the structure of the price control by not allowing companies wholly or mainly in England to have performance commitments or ODIs for non-household retail because it was being opened up to competition. Similarly we required companies wholly or mainly in Wales to have performance commitments or ODIs for non-household retail because the great majority of non-household retail customers had no choice of supplier during the price control period.

Price-control-specific performance commitments and ODIs might fit with customer preferences. Currently four companies have performance commitments relating to water resources and three companies have performance commitments relating to bioresources at PR14, which suggests that these issues mattered to some customers.

At this stage we have not reached a definitive conclusion, but our initial assumption is that performance commitments will be specific to particular price controls to ensure the revenue companies receive from customers under each price control is linked to service level commitments for that price control. Performance commitments specific to a price control also avoid the associated ODIs being used as a way of transferring revenue between price controls. We invite stakeholders' views on this issue.

We will consider performance commitments and ODIs that span more than one price control and invite views on how these could operate in practice.

#### **2.7.4 Coverage and the number of performance commitments**

In this section we have discussed a number of areas that companies might want to cover with their performance commitments. We recognise that there is a limit to how many performance commitments a company can reasonably expect to engage with its customers on. It will be for companies to balance the need for a reasonable number of performance commitments and ODIs with ensuring all of their customers' main priorities in terms of outcomes are covered.

##### **Consultation question on common performance commitments**

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

### 3 Setting stretching common commitment levels for the common performance commitments

**Table 3.1 - our proposals on setting stretching common commitment levels for the common performance commitments**

Proposal on setting stretching common commitment levels for the common performance commitments	Status
<p>We consider that we could apply stretching commitment levels based on comparative assessments to six of these common performance commitments. These six performance commitments are: water quality compliance, supply interruptions, internal sewer flooding, wastewater pollution incidents, mains water bursts and sewer collapses.</p>	<p>We are inviting views on our proposal that we could apply stretching commitment levels based on comparative assessments to six common performance commitments. We expect to set out our decision on which common performance commitments we could apply comparative assessments to alongside the methodology consultation.</p>
<p>As we might set common commitment levels for six common performance commitments we are consulting on how we could carry out comparative assessments for those six.</p>	<p>We are inviting early views on this issue. We expect to consult on a preferred approach for comparative assessments in the methodology consultation.</p>

#### 3.1 Introduction

It is important for customers' trust in the outcomes regime that they can be sure that companies' performance commitment levels are appropriately stretching. Common performance commitments allow us to compare the ambition of companies' proposals and, if needed, to set stretching performance commitment levels for poorer performing companies, which benefit the customers of those companies.

At PR14 we used comparative assessments to set common upper quartile commitment levels for five measures: supply interruptions, water quality compliance, water quality contacts, pollution incidents and internal sewer flooding. This process was made more complicated at PR14 by the variation in definitions companies had used for these five measures. As a result we had to use a standard definition to calculate the common commitment levels and translate them into some companies' bespoke definitions, which reduced the accuracy of the challenge process. In the case of internal sewer flooding, the complexity of the adjustments needed meant we could not apply the comparative assessment as effectively and were only able to

intervene to make the commitment levels more stretching for those companies who were clearly some distance from upper quartile performance.

If necessary we might need to set common commitment levels for the common performance commitments through comparative assessments at PR19. However, if companies rise to our challenge in relation to the use of more innovative customer engagement techniques and setting stretching performance commitment levels, companies might propose genuinely stretching performance commitment levels in their business plans that require no intervention from us, as a result of comparative assessments. However, we might still need to carry out comparative assessments in order to check the stretch in companies' proposed performance commitments. In addition, when we review business plans we might obtain new information on companies' performance and proposals which was not available to customers, CCGs or companies, which might require us to intervene to protect the interests of customers through the application of common commitment levels.

### 3.2 The common performance commitments to which we might apply common commitment levels

We have proposed a list of ten common performance commitments for PR19 in the previous chapter. We consider that we could apply common commitment levels based on comparative assessments to six of these with two measures yet to be defined sufficiently for us to make a proposal. The other common performance commitments would still benefit from comparative assessment and challenge even if they might not be suitable for common commitment levels. We explain our reasoning in the table below.

**Table 3.2 – Proposed common performance commitments and our provisional view on whether we could apply a common commitment level**

Measure	Provisional view on common commitment level	Reason
1. Future customer experience measure	Unclear at present	We have not yet defined the future customer experience measure. The existing SIM does not have a common commitment level set out in advance. It seems likely that we will set any commitment levels or thresholds for rewards and penalties commonly across the sector for this measure.

2. Water quality compliance	Yes	We are still engaging with the DWI and the sector on the appropriate measure of water quality to use as a common performance commitment for PR19. However, the existing measures all appear amenable to setting a common commitment level.
3. Supply interruptions	Yes	Supply interruptions can be compared across the sector and therefore it is a suitable measure for setting a common commitment level. We will need to consider, if the definition of interruptions changes, the extent to which we can still set a common commitment level.
4. Distribution input / leakage / per capita consumption	No	Whichever of these three measures becomes a common performance commitment at PR19, we currently consider that a common commitment level might not be appropriate because of the different water resource situations facing different companies. This means different commitment levels might be appropriate for different companies. The company-specific commitment levels could still be informed by comparative assessment and challenge.
5. Abstraction incentive mechanism	No	The extent to which the AIM applies to companies varies, so a common commitment level might not be appropriate. However, we still plan to publish all companies' performance on the AIM with contextual information so that stakeholders can make informed comparisons.
6. Internal sewer flooding	Yes	Internal sewer flooding, normalised, can be compared across the sector and therefore might be suitable for setting a common commitment level.
7. Pollution incidents	Yes	Pollution incidents, normalised, can be compared across the sector and therefore might be suitable for setting a common commitment level.
8. Water mains bursts	Yes	Water mains bursts, normalised, can be compared across the sector and therefore might be suitable for setting a common commitment level.
9. Sewer collapses	Yes	Sewer collapses, normalised, can be compared across the sector and therefore might be suitable for setting a common commitment level.
10. Possible new common measure or measures of resilience	Unknown at present	At this stage we do not know what the common measure or measures of resilience might be and whether it / they would be suitable for a common commitment level.

### 3.3 Improving the process for comparative assessments at PR19

Since we might set common commitment levels for the common performance commitments at PR19, we are consulting on how we should carry out the comparative assessments.

We are proposing some process improvements for how we carry out any comparative assessments at PR19 compared with PR14. We plan to carry out the comparative assessments during the risk-based review which is earlier in the process than PR14. By requiring companies' common performance commitments to be based on consistent definitions the comparative assessments will be less complex and easier to understand for all our stakeholders. In addition, we are encouraging companies to make more use of comparative information in their customer engagement which should mean that companies' proposed commitment levels for the common performance commitments are more stretching in the first place, and the comparative assessments will result in fewer, if any, interventions.

However, we cannot rule out that when we review business plans we might obtain new information on companies' performance and proposals which was not available to customers, CCGs or companies, which might require us to intervene to protect the interests of customers through the application of common commitment levels.

### **3.4 Options for applying comparative assessments at PR19**

If we apply comparative assessments to set common commitment levels for some of the common performance commitments at PR19 there are many ways we could do this. We have summarised some of the options across seven factors in the table below. We have highlighted in pink the PR14 approach and we describe it in more detail in the discussion below.

**Table 3.3 - Options for how we might set common commitment levels for some of the common performance commitments at PR19**

What type of assessment?	What performance data is used?	Annual data or averaging?	What is it applied to?	Should it be applied to the PC or ODI?	What glide path to the target should there be?	Adjustments for company specific factors?
Upper quartile: top 25%	Historical data	Annual data	Basket of measures	PC level	3 years	Automatic
Upper quintile: top 20%	Forecast of future performance	3-year average data	Individual measures	Penalty deadband and/or penalty collar	2 years	Assessment process
Average of top three performers	Dynamic (pure)			Reward deadband and/or reward cap	1 year	Limited
Upper decile: top 10%	Dynamic (pure and lagged)			Penalty and/or reward rates	None	None
Frontier: best performer	Dynamic (ratchet)					

For PR19 we need to consider how we might carry out the comparative assessments. We look at seven different aspects of the comparative assessments individually, but our final approach needs to consider all seven aspects jointly.

### 3.4.1 An upper quartile challenge or tougher

At PR14 we used the upper quartile to set the common performance commitment levels. For PR19 we will also consider tougher options such as the upper quintile, average of the top three performers, the upper decile and the frontier company. These approaches would generate more demanding commitment levels than an upper quartile approach.

### 3.4.2 The data on which to base the assessment

At PR14 we used historical data on the upper quartile for the three financial years 2011-12 to 2013-14. A difficulty with using historical data is that upper quartile performance in 2011-12 might not be that stretching for performance commitment levels that extend to 2019-20. An alternative approach is to use forecast data which might apply an expected efficiency gain to companies' performance and would result in a more stretching commitment level than using the historical data.

An alternative to fixed commitment levels is to make the commitment level dynamic in some way. For example, a pure dynamic upper quartile commitment level would mean that companies have to achieve upper quartile performance every year which is similar to how a competitive market operates. In a regulated setting some of the drawbacks are that not all companies can be upper quartile every year and by definition three quarters would not attain the commitment level. A second possible drawback is that companies would not know their commitment level in advance, although this can have the advantage that a company has to stretch itself in anticipation of a demanding commitment level. A third drawback is that if the sector's performance slips back in a particular year the dynamic commitment level would become easier for that year.

The pure dynamic approach can be adapted by using a lagged approach to the data and a ratchet effect. In such a case the dynamic commitment level for year 0 would be the upper quartile performance for year -1 or year -2. If the base year for the commitment level was year -2 the commitment level would be known in advance of year 0. If the base year for the commitment level was year -1 the commitment level would be known a few months into year 0. In addition, to avoid the problem that a pure dynamic commitment level could become easier if the sector's performance slipped back, a ratchet could be applied so that the commitment level can get more demanding during the period, but not easier.

### **3.4.3 Average or individual data**

Across companies' current performance commitments there are some which are averaged over more than one year, typically three years, to measure enduring performance and to smooth variation in the data due to effects such as weather or one-off incidents. At PR14 we derived upper quartile commitment levels which we applied to annual data in nearly all cases. We could consider for PR19 applying the common commitment levels to three-year average data to reward only consistent stretching performance and avoid penalties based on one year's data. A drawback of this approach is that it would weaken the incentive for companies to deliver stretching performance every year for their customers.

### **3.4.4 Applying the commitment levels to individual measures or a basket measures**

Some water companies have raised the issue that the cost allowances at PR14 apply to all companies' costs taken together within a price control whereas the upper quartile challenges for outcomes apply to individual measures.

United Utilities published a paper in the market place of ideas which considered how a basket approach to the comparative assessments could work. The paper explains that the advantages of such an approach are that it increases the scope for local engagement, as trade-offs can be made between the different measures; and it makes it less likely that performance on individual measures would go beyond the economic level.

In summary, the method United Utilities describes involves scoring each company's performance on each aspect of service. The scoring could be based on the range between best and worst performing company<sup>5</sup>. This would give a range for each service measure of 0 to 100. The paper notes that we used a similar approach in the past in the Overall Performance Assessment (OPA) scoring. We could then calculate total scores for each company and calculate an upper quartile score. Companies would then have to set their common performance commitments at levels that achieved the upper quartile (or upper quintile, etc.) but they could engage with their customers on how best to do that.

There are drawbacks to the basket approach such as the degree of complexity which might make it less transparent to customers and other stakeholders. In addition, while the common performance commitments would remain common to all companies the commitment levels would be likely to vary and be less comparable across companies. The basket approach also allows companies scope to set less demanding commitment levels in areas in which they are performing less well (although they would need to be offset by more demanding commitment levels on the other components of the basket). Using a basket approach might also raise the question of whether a company should be allowed to earn rewards on any of the components of the basket unless it hit its commitment levels on all of them.

We would be interested in respondents' views on the basket approach to comparative assessments.

### **3.4.5 To what do we apply the common commitment levels?**

The comparative assessments are designed to check companies' performance commitment levels and to develop common commitment levels which we can apply if companies' proposed performance commitment levels are not stretching enough. At PR14 we found that when altering the performance commitment level we also had to change the reward and penalty deadbands to avoid perverse results such as there being a reward deadband at a worse level of performance than the performance commitment level. We therefore consider that for PR19 if there are reward and

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<sup>5</sup> This could be in the form:  $Score = 100 \times (1 - (Company - Best) / (Worst - Best))$ .

penalty deadbands we will again have to adjust them if we intervene to change the performance commitment level as the result of a comparative assessment for common performance commitments.

When adjusting any penalty and reward deadbands we can have large impacts on the maximum rewards and penalties if there is also a penalty collar and reward cap which we do not change. Typically the effect would be to significantly increase the maximum penalty and reduce the maximum reward. To avoid this effect at PR14 we moved the reward cap and penalty collar by the same absolute amount as the reward deadband and penalty deadband to maintain the reward and penalty ranges. We can see benefits of adopting this approach again for PR19.

An area where we are considering a change for PR19 is the reward and penalty rates that apply to common performance commitments. At PR14 we did not adjust the reward and penalty rates proposed by companies for the common performance commitments as part of the interventions we made, except for a few cases where we required a company without a penalty on its common performance commitments to apply one. This resulted in companies having common commitment levels, but with the incentive to achieve those common commitment levels varying considerably across companies. This can undermine the use of common performance commitments with common commitment levels if companies have widely varying incentives to achieve them.

We are therefore considering the case for developing common reward and penalties where we have common performance commitment levels, which would need to be normalised in some way for the differences between the companies. We recognise that 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. We discuss how we might set industry-wide rewards and penalties for the common performance commitments in appendix 2.

#### **3.4.6 The use of glidepaths**

By a glidepath we mean the length of time a company has before its performance commitment is set to the common commitment level. At PR14 we applied a glidepath of two years for companies to achieve the common commitment levels for their common performance commitments i.e. the common commitment level was not applied until 2017-18. This reflected that we were applying what we considered to be stretching commitment levels and that it was the first time we had applied outcomes, but also that we applied the common commitment levels relatively late in the PR14

process. The two-year glidepaths also reflected that reaching the commitment levels might involve investments which take time to produce results.

We will need to consider glidepaths for PR19 in the round with the other aspects of the comparative assessments. While glidepaths were appropriate at PR14 when companies were being asked to achieve upper quartile levels on certain performance commitments for the first time, we would expect all companies to provide efficient service levels from the start of the next control period and therefore we consider it likely that glidepaths will not be required at PR19.

### **3.4.7 Making adjustments for company-specific factors**

Following our application of the comparative assessments at PR14 companies raised a number of company-specific factors, which they argued can affect their performance, in their representations on their draft determinations. At PR14 we considered 24 company-specific factors and applied a three-stage test:

1. Does the factor have a material impact?
2. Is the factor outside management control?
3. Does the factor affect some companies in a materially different way to others?

While none of the factors passed all three of our tests we did consider three areas in more detail that scored relatively highly against our tests: the impact of urbanisation on sewer flooding; the impact of source water types on water quality contacts; and the impact of network interconnectivity on supply interruptions. As a result of this further assessment, we intervened to introduce a reward incentive for supply interruptions for Dŵr Cymru.

For PR19 we need to consider what approach there should be for company-specific factors. As we are consulting earlier in the PR19 process than we did in the PR14 process on the common performance commitments and the comparative assessments, companies could submit their company-specific factors with their business plans, including appropriate support from customer engagement. We could then carry out the assessment of company-specific factors as part of the risk-based review. Given the well-established framework for company-specific factors, we would only expect to see well-evidenced and robust cases and we could take account of company's use of company-specific factors in the risk-based review.

Any differences between England and Wales could be captured by such adjustments, if we conclude that adjustments for company-specific factors are

appropriate. However, we would take into account that we consider stretching performance commitments are important to both Welsh and English customers.

### **3.5 Overall approach to comparative assessments**

We will develop a preferred option for comparative assessments in the PR19 methodology statement. We invite views on how we can set common commitment levels in a way which grounds those commitments in customer engagement.

At this stage we are considering commitment levels which are more challenging than upper quartile using forward-looking data or which are dynamic over time. Our initial view is that the drawbacks of using a basket approach to the comparative assessments probably outweigh the benefits. We think there might be a case for common rewards and penalties (normalised in some way) for the common performance commitment levels. We further consider the case for applying glidepaths is relatively weak and we think there should be limited scope for the application of company-specific factors to the comparative assessments. We welcome respondents' views on the points discussed above.

**Consultation question on setting stretching common commitment levels for the common performance commitments**

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

## 4 Making leakage commitment levels more stretching

Proposals on making leakage commitment levels more stretching	Status
1. We discuss some ideas for how leakage performance commitments could be made more stretching.	We are inviting early views on how leakage performance commitments could be made more stretching. We expect to consult on a preferred approach in the methodology consultation.

### 4.1 Introduction

Customer engagement consistently finds that reducing leakage is a customer priority. In section 2 we propose some measures which could be common performance commitments for PR19. We suggested that leakage could be one of them, although if we use distribution input or per capita consumption we might not require leakage as a common performance commitment.

All companies, bar one, outperformed their leakage performance commitments for 2015-16, some by a considerable amount. Companies' commitments to reduce leakage ranged from no reduction to a 14% reduction from 2015/16 to 2019/2020. We discuss below some ideas on how our approach to leakage from PR14 could be improved if we adopt it as a common performance commitment for PR19 which we welcome stakeholders' views on.

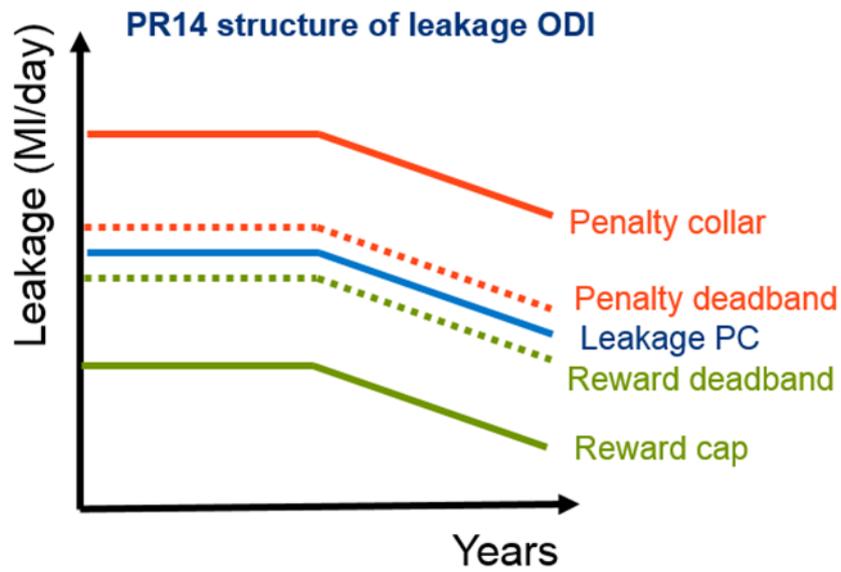
### 4.2 PR14 guidance on leakage performance commitments

There were four main aspects to our PR14 guidance on leakage performance commitments:

1. Companies had to have regard to the sustainable economic level of leakage (SELL) as developed in their water resources management plans (WRMPs).
2. Companies had to include effective evidence for their proposed performance commitment level, in particular, if their proposed leakage performance commitment levels did not reflect an overall reduction in leakage over 2015-20.
3. We expected to see performance commitment levels and ODIs that were robust, challenging and evidence-based.

- We also expected companies to publish their actual level of leakage (measured as total leakage, including customer supply pipe leakage) at least annually as a key performance indicator.

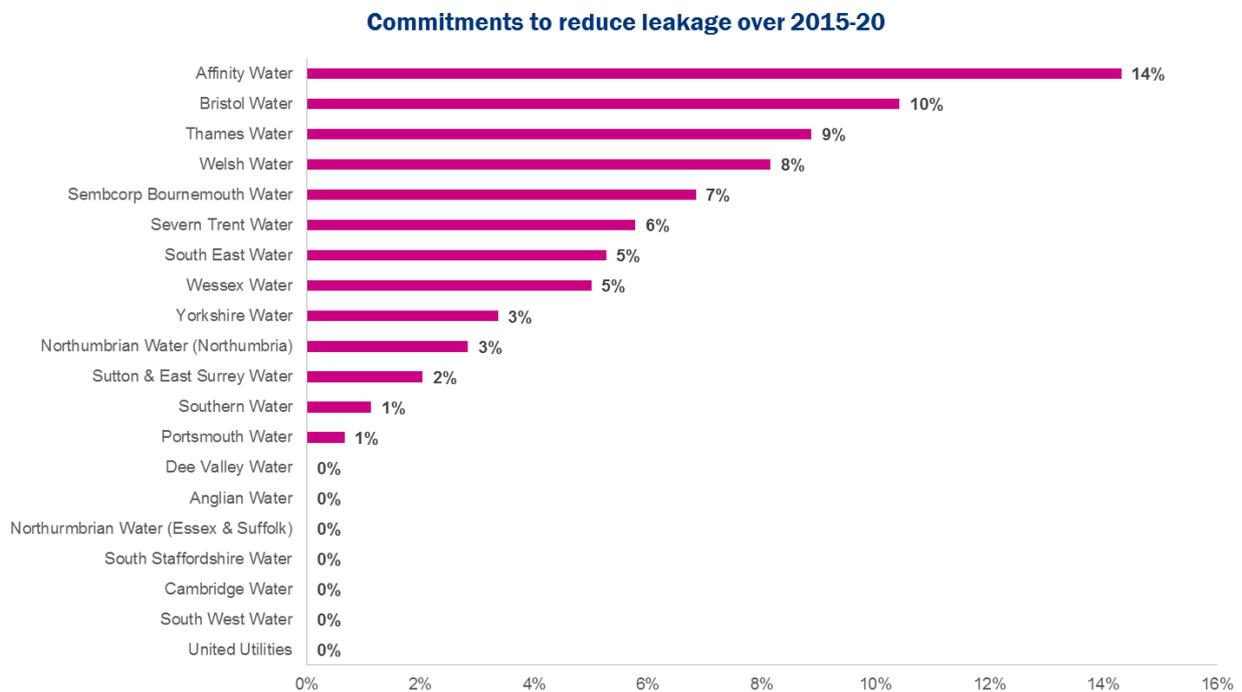
**Figure 4.1 - An illustrative example of a company's leakage outcome delivery incentive at PR14**



Companies' commitments to leakage reduction ranged from no reduction to a 14% reduction from 2015-16 to 2019-2020<sup>6</sup>. This is illustrated below. Those companies who proposed no reduction in leakage generally did so because they were operating below the SELL and had no pressing water resource issues.

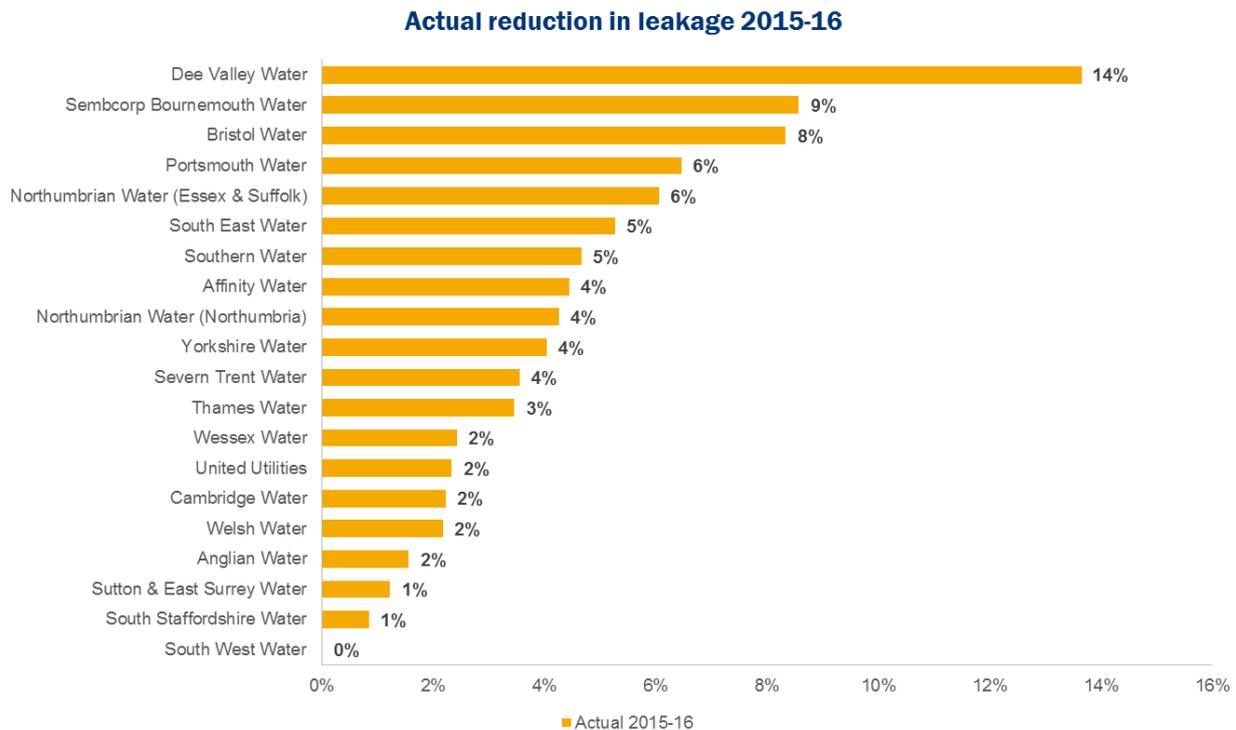
<sup>6</sup> Note that Anglian Water's performance commitment is for no reduction in leakage by 2019-20, but its plan is to reduce leakage by 10% over the 5-year period funded by an in-period ODI reward.

**Figure 4.2 –Companies’ performance commitments on leakage reduction from 2015-16 to 2019-20.**



The chart below shows companies’ performance in relation to leakage in 2015-16, the first year in which companies had performance commitments and ODIs. All companies, apart from South West Water, outperformed their performance commitments for 2015-16, some by a considerable amount. Although 2015-16 had a relatively mild winter, the outperformance by all companies, bar one, suggests that the performance commitments might not have been sufficiently stretching and that more challenging performance commitments for 2020-25 are possible.

**Figure 4.3 –Companies’ actual leakage reduction in 2015-16 compared with the previous year**



### 4.3 What are we proposing?

For PR19, we want to put in place an effective approach to leakage that improves resilience in the sector in the long-term for the benefit of customers and the environment. Our approach is consistent with the UK and [Welsh](#) governments’ guiding principles for water resource planning.

If leakage is a common performance commitment for PR19 we want to make the improvements outlined below:

1. The commitment levels that companies report for the common performance commitment should be measured on a consistent basis in total megalitres and based on financial years. Companies can still propose other performance commitments on other aspects of leakage if they want to, such as the number of days to spot and fix leaks.
2. Improve the consistency of data underlying leakage. We welcome the efforts by water companies to improve the definition of leakage for use from 2020 onwards. We understand that a working group is aiming to finalise a definition by the end of March 2017 to allow for shadow reporting from 2017-18 onwards. We will engage

with the working group on whether this definition is appropriate and whether it should be used for the common performance commitment. We will consult on our proposed definition in the methodology consultation.

3. Companies to report the sustainable economic level of leakage (SELL)<sup>7</sup>, and its range to us, in their business plans. Companies should explain the approach they have taken to the SELL. In particular, companies should explain what assumptions they have made about future improvements in leakage reduction efficiency in their calculation of the SELL. The company should explain how its leakage performance commitment level is appropriate in relation to the SELL, including whether a more stretching performance commitment is needed because the calculation of SELL is based on current efficiency rather than projected future improvements in leakage reduction efficiency. In this context we note the Environment Agency's aspiration that water companies could evolve away from using SELL for the 2024 water resources management plans.
4. 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.
5. 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.
6. Companies should explicitly state their performance commitments are consistent with their water resources management plan (WRMP) or explain any differences.
7. Companies should consider comparative information on leakage/property/day and leakage/km of main/day and explain why their leakage commitment level is appropriate in this context.
8. We will expect companies to provide a long-term projection for leakage levels – consistent with our policy on long-term performance commitments. The projection would need to be the same as in the WRMP or the company would need to explain any differences.
9. Companies will need to justify why they have adopted a whole company commitment level or regional commitment levels for leakage.

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<sup>7</sup> The SELL is the point at which further reductions in leakage would cost more than not reducing leakage, taking into account environmental and social factors and the cost of developing new water resources to compensate for the water lost through leaks. Leakage targets should be set at or lower than the SELL otherwise further leakage reduction would reduce costs.

We are considering whether companies' performance commitments for leakage should be based on three-year averages, as some are for PR14. We would welcome respondents' views on this point.

When considering companies' proposed leakage commitment levels we expect to assess the extent to which companies have taken account of our PR19 methodology statement, the guidance on Water Resources Management Plans and the benefits of demand-side solutions, including whether companies have properly valued the greater future options that demand-side measures allow for.

If leakage is not a common performance commitment at PR19 we would expect the points above to be taken into account by companies when developing their bespoke leakage performance commitments.

**Consultation question on leakage**

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

## 5 Other ways to make performance commitments more stretching

**Table 5.1 – Proposal on other ways to make performance commitments more stretching**

Proposal on other ways to make performance commitments more stretching	Status
1. We discuss our guidance on setting bespoke performance commitments and how it can promote more stretching performance commitment levels.	We are inviting early views on our guidance on setting bespoke performance commitments. We expect to consult on guidance for setting bespoke performance commitments in the methodology consultation.

### 5.1 Introduction

In this section we consider other ways in which performance commitments can be made more stretching.

We consider whether our guidance on setting bespoke performance commitments should involve consideration of the results of a wide range of customer engagement techniques, comparative performance information, historical performance information, expectations of future improvements and current marginal costs and benefits. The guidance will enable companies to set stretching performance commitments.

We discuss other ways in which performance commitments could be made more stretching such as setting performance commitments for new, innovative measures for which the commitment levels represent a genuine challenge to a company or developing a broad range of performance commitments for which the commitment levels set, represent a stretching package overall.

### 5.2 Setting bespoke performance commitments

As part of the methodology for PR14 we provided [guidance on setting bespoke performance commitments](#). Our business plan table requirements guided companies to set their performance commitment levels by considering the current annualised marginal costs and current annualised marginal benefits (as measured by marginal

willingness to pay and marginal other benefits) for several levels of service and selecting the one which delivered the highest net benefits. The aim was to ensure the performance commitment level was set at the economic level of service. Our methodology allowed for cases where performance commitment levels might be set below the economic level for reasons of affordability.

During and after PR14 there was some criticism that this approach depended on companies having precise and reliable information on marginal willingness to pay (WTP), marginal other benefits and marginal costs. In practice where the input information was unavailable or there were doubts about its validity companies used other justifications for setting their performance commitment levels. Companies also had to make judgments over which WTP value to use when their surveys often produced a range of values. In assessing companies' proposed performance commitment levels we also took into account other information such as a company's past performance and other companies' performance to cross check whether the performance commitment level looked appropriate.

We will propose guidance for setting performance commitment levels in the methodology consultation. However, we are setting out some initial thoughts for discussion in advance of that guidance.

Our [customer engagement policy statement for PR19](#) challenged the sector to develop its approach to customer engagement for PR19 in a range of ways including:

- exploring alternative and complementary tools to validate and test results from stated preference WTP surveys such as revealed preference WTP techniques, experiments, using evidence obtained through day-to-day contacts with customers and applying behavioural economic insights to the design and interpretation of the engagement. The use of additional tools and techniques should be proportionate to the issue being considered; and
- companies being transparent with customers about their relative levels of performance by using comparative information with consistent definitions.

The approach to setting performance commitment levels at PR19 might therefore involve more triangulation by considering the results of a wide range of customer engagement techniques, comparative performance information, historical performance information, expectations of future improvements and current marginal costs and benefits. In part, this reflects the reality of how companies set their performance commitment levels and how we assessed performance commitment levels at PR14. It also builds in the new approaches to customer engagement we are

promoting for PR19 and our emphasis on the need for performance commitments to be more stretching.

Using a wider evidence base should enable companies to set more stretching performance commitment levels. The wider evidence base and greater scope for judgment in setting performance commitments at PR19 means companies will need to engage with their customers on the factors they take into account and how they have balanced them when setting their bespoke performance commitments. The role of CCGs will be important in assuring how companies have engaged with their customers on this issue.

On the costs side, it can be difficult for customers and CCGs to challenge a company's estimate of its marginal or incremental cost<sup>8</sup>. We could require companies to provide more information to customers and CCGs about how they have calculated their marginal or incremental cost. We will consider if there is a way we could share information on the average or range of companies' marginal and incremental costs to provide a tool for customers and CCGs to challenge companies' on their marginal or incremental cost estimates. This might not be possible ahead of companies submitting their business plans.

Companies should make sure that when citing affordability concerns in setting the levels of their bespoke performance commitments they have thoroughly considered whether their performance commitments could be more stretching within customers' affordability constraints.

### **5.3 Making performance commitments more stretching through other means**

There are ways in which performance commitments can be made more stretching other than through more demanding commitment levels. These include:

- Setting performance commitments for new, innovative measures which represent a genuine challenge to a company to achieve and might involve significant changes in operating practices or culture for the genuine benefit of customers and / or the environment. One example might be the new customer experience measure which we discuss in appendix 5;
- Developing a broad range of performance commitments which taken as a package represent a stretching challenge across a wide range of the company's services and a number of price control areas;

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<sup>8</sup> Marginal cost is the change in cost associated with an additional unit produced. Incremental cost is the change in cost from a particular increment in production, which might be more than one unit.

- Definitions for performance commitments which allow for fewer or no exceptions;
- Performance commitments jointly owned by more than one company to achieve shared outcomes, e.g. companies working together to achieve the best / lowest cost / most sustainable outcome for a catchment;
- Setting a profile for the performance commitment which leads to an improvement year-on-year rather than purely aiming for a commitment level by the end of the 5-year period; and
- Committing to delivering commitment levels through best practice rather than finding work arounds to meet them.

We encourage companies to consider other ways to make their performance commitments more stretching.

**Consultation questions on other ways to make performance commitments more stretching**

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

## **6 Impact assessment on making performance commitments more stretching**

We are considering a range of approaches to make performance commitments more stretching at PR19. These include

1. improving customers' access to information
2. common performance commitments
3. identifying areas for bespoke performance commitments
4. common commitment levels for the common performance commitments
5. improving the approach to leakage performance commitments
6. issuing guidance on setting bespoke performance commitments

We believe that these changes will lead to tangible benefits to customers compared to the current situation at little additional administrative cost to companies or us.

### **6.1.1 Improving customers' access to information**

The improved availability of information, such as easily available comparative information on company performance, using common and standard definitions, should strengthen the ability of customers and CCGs to challenge their companies on their proposed performance commitments. This is likely to lead to more stretching performance commitments than if the information was unavailable or not easily available.

There are some costs to collecting together comparative performance information and standardising the definitions. However, much of this work has been already carried out by water sector organisations such as the Discover Water dashboard, CCWater and the sector's regulators. We would expect that the work involved in standardising some definitions further will have relatively low costs compared with the benefits to customers of there being more information with which to challenge the stretch in companies' performance commitments.

### **6.1.2 Common performance commitments**

Common performance commitments ensure all companies have performance commitments for those issues which matter most to customers across England and Wales. We based our assessment of those issues which matter most to customers primarily on the customer engagement companies carried out at PR14. Another

benefit of common performance commitments is that they allow us to compare the ambition of companies' proposals. We believe that this will improve the quality of our assessment and therefore of our regulatory approach. It will also allow us to set stretching performance commitment levels for poorer performing companies based on a strong benchmark for good performance, if necessary. This will allow us to raise standards across the industry and to deliver customer benefits.

The main drawback of common performance commitments is that they override, to some extent, any specific performance commitments that companies might have made to their customers in the areas covered by our proposals. However we expect this to be mitigated in two ways. First companies and customers will be engaged in helping determine the common performance commitments. Second, there will be scope for companies to propose their own bespoke performance commitments based on local customer engagement alongside the common performance commitments.

### **6.1.3 Identifying areas for bespoke performance commitments**

We consider that bespoke performance commitments are an important complement to common performance commitments and have identified areas which we think such bespoke commitment should cover. By prescribing these areas we can ensure that companies are covering issues that we consider important, such as customers in vulnerable circumstances<sup>9</sup>. However, we do not intend to prescribe the exact form of these commitments in order to allow for innovation.

We recognise that prescribing common areas limits companies' ability to propose performance commitments based on their customer engagement to some extent. However, it still leaves plenty of scope for companies to engage with their customers on what particular measures to use for their performance commitments.

### **6.1.4 Common commitment levels**

We suggest that we could set common commitment levels for a subset of the common performance commitments. Common commitment levels would enable us to set stretching commitment levels for the common performance commitments, if necessary, which we consider would benefit the customers of all companies. It would also avoid certain counterintuitive results that could result where a company can earn a reward for the same performance on the same measure for which another

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<sup>9</sup> We note that most companies have their customers' support for higher bills to support lower bills for customers whose circumstances make them vulnerable.

company incurs a penalty. This is likely to be perceived as unfair by customers of the company with the less demanding commitment level and by the company with the more demanding commitment level and therefore could undermine trust in our outcome framework.

A drawback of setting common commitment levels for common performance commitments is that it moves us away from commitment levels being set through local customer engagement, reflecting customers' local preferences and companies' particular circumstances. We are inviting views on how we could set the common commitment levels in a way which grounds these commitments in customer engagement. We also discuss whether allowances should be made for company-specific factors which could mitigate this drawback.

### **6.1.5 Improving leakage performance commitments**

For leakage we are proposing that companies take into account a wider set of information when proposing their performance commitments than they are taking into account now, including projected future improvements in leakage reduction efficiency and comparative information on leakage (based on normalised data). A benefit of this approach is that it could encourage companies to set more stretching targets for leakage reduction. The current leakage performance commitments might not be sufficiently stretching as all but one company outperformed their commitments, some by a considerable margin, in 2015/16.

Our proposed approach could result in companies setting leakage performance commitment levels that are different to (and more challenging than) those that would be set by calculating the sustainable economic level of leakage (SELL). However, given the uncertainty of SELL calculations, the high priority customers give to leakage reduction and the challenge the sector faces in relation to resilience, we believe that this is a preferable way to proceed.

### **6.1.6 Issuing guidance on setting bespoke performance commitments**

We are proposing some changes to our guidance on how to set bespoke performance commitments. It will take account of our customer engagement policy statement for PR19, which challenged the sector to explore alternative and complementary tools to validate and test results from stated preference willingness to pay results thus improving on our methodology from PR14. This should enable the setting of more stretching performance commitments.

A potential drawback of the revised guidance is that it might involve more triangulation and judgement based on the results of a wide range of customer engagement techniques and other information. This will increase complexity of our approach. We are commissioning further work and consulting with the sector on how the guidance can be most effective and practical to address this potential drawback.