



Outcomes Consultation  
Water 2020  
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Dear Sir

**PRT Response to Ofwat Consultation on the Outcomes Framework for PR19**

Thank you for the opportunity to respond to the consultation on the outcomes framework for PR19, published 29 November 2016. Firstly we would like to recognise the considerable amount of work that has clearly been undertaken by Ofwat in considering this issue in such detail.

Similarly we, as a Company, have had detailed discussion at Board, senior and operational manager level. It has been a timely reminder of the goal to continue to put customers at the heart of everything we do at Portsmouth Water.

The development of outcomes proposed by companies based on their own customers' expectations was generally welcomed at PR14. We moved from an output based regime to one that focused on outcomes important to customers and other stakeholders. However, as an industry we recognise that there are issues, which are identified in the consultation, where we believe we can collectively improve the framework.

During the PR14 process our Board, in particular, challenged the principle of "rewards and penalties" accruing as a result of over or under performance. Customer research had indicated that customers did not want to pay higher bills as a result of companies exceeding their performance commitments. Whilst we acknowledge that the incentive to provide "better" service is important, the setting of the performance target in the first place is key if a financial incentive is to be applied.

As a result of our research, of the 13 ODIs in our Business Plan (December 2013), we proposed that only 4 ODIs would have a financial incentive and 9 would be reputational. Ofwat challenged our plan significantly on this issue, and argued strongly that the balance of incentives was not appropriate. Throughout 2014 we discussed the balance and magnitude of the financial incentives with Ofwat until at the Final Determination we, generally, were comfortable with the package with only 4 reputational and 9 financial ODIs.

Whilst we have recently agreed to a licence change to permit "in period" adjustments to customer bills for rewards and penalties, we continue to believe this is a sensitive issue and we would only seek to recover a reward for sustained performance. This is also why almost all of our financial ODIs are assessed and applied over the whole AMP6 period, 2015-20. We would advocate that future ODI packages should reflect sustained improvements in service, not relatively short term performance.

Finally, whilst the desire is to recognise performance, we should also take into account any cost associated with full compliance. The proposals in this consultation are likely to increase the complexity of the regime and therefore to further increase the cost of collection and auditing. We should only undertake such developments if we are confident, *ex ante*, that there are clear customer benefits in doing so. This is particularly pertinent in the discussion re sub-measures.

In summary, we agree that in many cases outcome delivery incentives were developed, in association with Ofwat challenge, relatively late in the PR14 process. We welcome the proposals to improve the overall process to deliver a set of challenging targets which will genuinely improve customer experience.

We look forward to working with you and other stakeholders to develop our ODIs for the next business plan and then to deliver against them. Our response to the 10 specific questions is attached.

Yours faithfully



**Helen Orton**  
**Finance and Regulation Director**

## 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?

At PR14 in particular we did not provide much comparative data to customers as part of our specific research programmes. When we did state, for example, that Portsmouth Water had the lowest level of water bill in the industry there was quite often a change in view on an issue.

This supports the view that customers and stakeholders do value the use of comparators and quite often this can change their attitude to an issue. It is, however, just as important to explain why differences in performance may occur between companies. It is not only for poor performing companies to explain their performance but also for industry leading to provide reasons for their relative out-performance as this provides very important context for both customers and other stakeholders.

We believe the use of comparative performance information is a good step forward for stakeholders and the use of the new “Discover Water” website should play an important role in providing access to consistent data to all stakeholders. It should be one important element of information in ensuring the performance commitments at PR19 are stretching. However, we believe that there should also be sufficient flexibility to recognise that different companies face different issues and challenges which may inherently impact relative performance. There should also be allowance to recognise that an appropriate “glide path” may be needed by companies as relative performance is moved over time.

It will be the responsibility of the company to demonstrate how it has used any comparative data in establishing its performance commitment.

However, to have confidence in the comparisons, clear and precise definitions are required and confirmation that all companies apply each consistently, both across the sector and over time. That said, we would caution against significant increases in detail, which will be costly to implement with potentially limited impact on the results. The recent work on consistency undertaken by Water UK suggests that there may be a shift in the underlying data as individual companies change their methodology. This needs to be implemented carefully to ensure that companies are not “penalised” if a change in definition or methodology results in an apparent “step change” in performance.

Finally, whilst recognising that the use of comparative data is very important, given the long term nature of the industry it should also be clear that trends in these metrics over time are critical to their effective use.

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

The consultation proposes the explicit introduction of 10 performance commitments which are common to all companies. Three relate specifically to wastewater and are not therefore of direct relevance to Portsmouth Water. All other proposed ODIs are currently included in our PR14 ODIs with the exception of distribution input, AIM and resilience. We comment further on each later in this response.

The introduction of common performance commitments does not and should not negate the use of bespoke ODIs which can reflect local customer expectations and/or company specific issues and challenges.

The current list is very much wholesale related, and relies on the customer experience measure to provide an indication performance of the retail business. We currently include per capita consumption in our retail plan as it reflects progress by customers to use water efficiently.

Further, specific ODIs will need to be established to measure the performance of the new “water resources business.”

Therefore, whilst overall we support the introduction of common ODIs we highlight that there is a significant change in policy from PR14 where companies established their ODIs independently, based on its customers’ research in particular.

We have the following comments on each of the ODIs proposed.

**1. Future customer experience measure** - We are supportive of the continuation of a satisfaction score based on a recent customer experience, but have some detailed observation in response to Q6 below.

**2. Water quality** – we believe that this is *the* top customer priority and currently have both Mean Zonal Compliance and customer contacts in our ODIs to reflect this. There is no reference to the current work DWI are undertaking to develop a new water quality compliance measure. We feel strongly that this should be considered as a potential measure of water quality.

**3. Supply interruptions** - We agree that long (unplanned) interruptions are significantly of greater impact on customers than relatively short (planned) interruptions where customers are managed clearly in advance of any planned event. We believe any measure should recognise these two different causes of an interruption.

We have recently adopted a new process of mains renewal, including slip-lining. This is significantly cheaper than traditional open cut techniques, especially over greater lengths. However, typically this means that customers are without water for over 3 hours with a smaller impact on road users. When setting our ODIs we will test if customers are willing to accept greater duration of interruption for a lower bill.

In addition, any performance commitment should also recognise the cost impact of establishing the start time of when customers go without water. The current WaterUK project is considering this issue in particular.

**4a Distribution Input** – Performance commitments for distribution input could, in principle, work, though it would require normalisation by property or population changes and take account of non-household use changes to be comparable. This effectively would move us to a measure like per capita consumption. Further, Distribution Input itself is very weather dependent and should be looked at over the long term. We would not support this as an ODI.

**4b – Leakage** – this is a sensitive and emotive issue with customers and we provide more detail in our response to Q4 below. We believe it is inevitable that leakage is an ODI. However measured and normalised, leakage should continue to be an ODI and a focus on a longer term trend would be appropriate given that this measure can be significantly impacted by variations weather. For example, the winter of 2015/16 was very mild and leakage was an average of 28.1 Ml/d but the winter of 2016/17 has seen periods of severe frost and an average level of leakage above our target of 29.95 Ml/d.

**4c per capita consumption** – this is a measure that customers readily understand and historically expectations for declining pccs have been advocated by Defra in particular. Like distribution input, per capita consumption is very weather dependent and should be looked at over long term. We would support this as an ODI.

**5 - Abstraction Incentive Mechanism** – we have consistently stated that AIM is not the appropriate mechanism to manage abstraction at environmentally sensitive sites. The Environment Agency have the duty to set our abstraction licences to ensure abstraction is not damaging the environment and we believe this is the appropriate regulatory mechanism to deliver this outcome. Accordingly we would not support this as an appropriate ODI.

**8 – Bursts** – this, again, is a measure we monitor as part of our current ODIs. Historically Ofwat monitored the serviceability of the infrastructure through a basket of infrastructure asset performance measured. The one that was most readily understood by all stakeholders was bursts. A tolerance around any performance commitment is appropriate to reflect variations in weather conditions and this is more likely to be effective as a “longer term” measure. We would support this as an ODI.

**10 – Resilience**- this is clearly a key expectation of government in particular. We provide more detail on our views in our response to Q8 and Q9 below.

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

We were broadly supportive of how the common performance levels were set at PR14 as shown in Table 3.3, page 29 of Appendix 1 of the consultation.

Our preference would be to base any targets on actual data as opposed to forecasts and judge performance on a three year average to ensure one-off issues do not result in disproportionate financial rewards and or penalties.

Whilst aggregation of measures into a basket of ODIs, akin to the Overall Performance Assessment, could help ensure financial rewards align to any regulatory target for the return on equity, we believe establishing one set of weights (to apply equally to all companies) for the basket will be a challenge. It will not reflect individual customer weightings for any individual company and move away from the principle applied at PR14.

Again we feel the use of two year glide paths and limited recognition of company specific factors applied at PR14 was reasonable and would support continuation at PR19.

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

Leakage levels can be significantly impacted by variations weather. For example, the winter of 2015/16 was very mild and leakage was an average of 28.1 Ml/d but the winter of 2016/17 has seen periods of severe frost and an average level of leakage above our target of 29.95 Ml/d. As such it is essential to consider trends and employ an element of averaging in determining the performance commitment.

Accordingly, we would strongly caution the conclusions made in the consultation by Ofwat in relation to leakage performance in 2015/16; it was a very mild winter and not an indication that targets were soft.

Further, any revision to methodology of calculation will result in a change to the level of leakage. Our initial analysis suggests the proposed changes in methodology will increase our baseline leakage which in turn will increase the Sustainable Economic Level of Leakage.

Looking at the 9 questions posed in turn:-

- 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.**

This appears to be sensible and well founded.

- 2. Improve the consistency of data underlying leakage.**

The WaterUK leakage convergence project should help with this. There are some remaining “unknowns” in total leakage, particularly around plumbing losses and whether they are properly measured. The leakage measurement stream of the UKWIR “achieving zero leakage by 2050” programme should also help with this.

- 3. Companies to report the sustainable economic level of leakage (SELL), and its range to us, in their business plans.**

We agree with this requirement. There will always be a need to make economic assessments of plans, whether for leakage or other actions. The methodology of the economic assessment that must evolve as our knowledge of the costs and benefits improves.

- 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.**

Portsmouth Water is in an unusual position with regard to the scope for water trading. It is one of the few companies in the South East currently without a supply-demand deficit in the medium term, but its scope to trade water in the short term is limited by the willingness of other players to trade with it and the current lack of adequate infrastructure to facilitate large transfers.

So although in the long term a much lower leakage level may be economically optimal, in the short to medium term it is not economically optimal to reduce leakage significantly and

it is not within the control of the company to decide on when a significant change of leakage level would be optimal as this will be influenced by levels of bulk trading requested from other companies.

There is a political and environmental dynamic which may be difficult to “monetise” in this type of analysis. It centres on whether it is “reasonable” to effectively ignore the wider water resource challenges across the region when such calculations are performed at a company level. This point, however, is likely only to be relevant to Portsmouth Water.

**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.**

This appears to be reasonable. However some areas will experience significant growth in the next few years, including parts of the Company's region, so to maintain or reduce leakage when properties or length of main are increasing may not be realistic.

**6. Companies should explicitly state their performance commitments are consistent with their water resources management plan (WRMP) or explain any differences.**

WRMP commitments need to be delivered for long term planning. This is not necessarily consistent with the stretch targets that Ofwat is trying to encourage. This potential issue needs to be thought through carefully.

**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.**

Yes, but this should not be a major issue and differences between companies should firstly be understood – not taken as a reason to drive targets.

**8. We will expect companies to provide a long-term projection for leakage levels – consistent with our policy on long-term performance commitments.**

Including challenging leakage targets in the WRMP increases risk and this should be recognised in the headroom assessment, which is an allowance in the methodology to capture the degree of uncertainty built into the forecasts.

**9. Companies will need to justify why they have adopted a whole company commitment level or regional commitment levels for leakage**

We have confirmed with the EA that we operate one water resource zone – given the integration of our network. We are effectively able to transfer water from our western border to our eastern border.

In conclusion to this section, we would welcome the use of longer-term averages in leakage targets; 3 or 5 years would be a useful timeframe that allows severe winters to be accommodated without the need to spend significant money in the short term to achieve the annual target as this may not be an efficient use of money.

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

At PR14 we had a number of bespoke ODIs which either had low financial incentives, such as our commitment to biodiversity, or were reputational, such as our survey of developer satisfaction.

By their very nature, it is unlikely that directly comparable data will exist but with biodiversity for example, our CCG looked very much to Natural England to confirm that the Company plans are reasonable and indeed challenging based on their knowledge of what other companies are achieving.

In terms of factors to take into account, we would suggest that these ODIs are clearly supported by customers and customer research and that the CCG confirm the level is appropriate having reviewed the evidence. Other regulators, such as DWI, Natural England and EA, will have a role to discuss with the CCGs.

We also concur with the observations that establishing willingness to pay and translating this into meaningful rewards and penalties in particular was a challenge, not only to calculate but also to explain to the CCG.

All of the discussions in this section of the consultation relating to willingness to pay in particular are relevant and should be considered further in the methodology statement.

## **More powerful outcome delivery incentives**

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

Looking at the 6 questions posed in turn:-

#### **1. The ultimate outcome?**

We are supportive of the continuation of a satisfaction score based on recent customer experience.

We suggest that a more generic perception score will not necessarily reflect our service but reflect the general reputation of the industry. We also note from the Economic Insight work that perception scores are influenced by outside factors, which could distort results. We would not support a general perceptions survey for use as an ODI.

Whilst we understand that Ofwat may want to understand the extent to which companies involve customers in the co-creation and co-delivery of solutions, we do not realistically believe that a SIM type survey could capture company engagement at this level of detail. However, a good overall score from customers should reflect good practice in such matters within a water company.

If made too broad, SIM could, in effect become an overall ODI, rather than a service levels ODI. We think a series of specific ODI's is appropriate to achieve focus on the matters that customers consider the most important. We therefore believe SIM should be a service satisfaction measure based on actual experience.

Whilst the overall satisfaction question score is accepted as our measure of service, the current survey gives us further information and context which we use to analyse the customer experience and learn lessons. A single question, without this context, would be valid but not as valuable to us in terms of our ability to use the survey as a business improvement tool. We would therefore prefer that a survey, along current lines, continues.

Finally we concur with the importance of monitoring the trust our customers have in us as the service provider as a whole and would be considered as a reputational indicator.

#### **2. Wholesale to Retail?**

We agree that the measure should capture the overall customer experience, covering both the retail and wholesale elements whilst businesses remain vertically integrated.

In the event of household retail competition we think that the measure should be redesigned at that time, rather than try to identify something now that could accommodate this development.

#### **3. Beyond water?**

We think that SIM should be an industry only measure, providing an opportunity to share industry performance with the media, and other interested parties. We consider that a

distinct industry identity is helpful in keeping important water issues in the public consciousness.

Companies will want to compare their performance outside the industry and seek to provide service levels that match or exceed those delivered over a broad range of other services. It is for this reasons that we are members of the Institute of Customer Service. We consider that these assessments provide sufficient challenge to improve service levels in line with the best external businesses.

#### **4. Beyond Contacts and Complaints?**

As stated earlier we believe that the measure should continue to assess satisfaction based on experience. This limits the measure to those customers that have contacted us. Typically this will be bill payers for billing matters, with a wider range of consumers having interaction in respect of operational issues and concerns.

Extending the survey beyond this group becomes a perception survey which has issues as previously described.

#### **5. A multi-channel approach?**

We believe that a wider range of contact methods should be used, so that those choosing to use modern, more interactive, communication can have their satisfaction measured and included within the overall score.

However, this does need to be carefully considered, with the chosen contacts being recognised as easily capable of being captured and used for survey. We would not want the burden of complicated and expensive capturing methods to discourage companies from increasing their contact methods or to impact adversely on retail costs.

#### **6. The role of complaints?**

We agree that written complaints are an important measure and the continued monitoring and reporting at an industry level attracts valuable media interest in the industry. We support this quantitative element remaining. We do not consider that defining written complaints is a barrier, assuming we continue only to count those received via advertised contact points.

We are less wedded to retaining unwanted telephone contacts, given new communication methods and the reliability of classifications between wanted and unwanted, which itself is determined by underlying processes built into billing systems.

#### **7. Incorporate vulnerability?**

Whilst aspirationally the views of those at times of vulnerability would feature in our customer service measure, we can see no easy way that this can form part of the SIM to a meaningful extent.

We believe that individually commissioned work would be a better approach in assessing how companies improve their services in this area over time.

## **8. Beyond end-users?**

As part of our current business plan we have an annual developer survey, and believe companies should review the service to niche groups via targeted work, as noted in the context of vulnerable customers.

We think that SIM should be a measure for water services customers. Widening the measure could make the results harder to interpret, both internally and externally. Again services such as developer services should be monitored separately, and could be subject to an ODI, but not as part of SIM.

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

As noted in our covering letter, we believe that our reputation is of significant importance and that the impact of publication of league tables is (and always has been) a highly motivational incentive, not only for management but also for staff.

It allows stakeholders, including CCGs to judge performance of the Company on a like for like basis as far as possible.

We understand the principle underpinning linking service performance to the cost of equity and that the level of ambition shown in the plan can be interpreted from the setting of performance commitments.

However we would challenge the view that customers will understand that rewards can lead to lower bill and our research which shows that customers do not support rewards supports this.

Further we need to understand the views of equity investors on this issue. It appears to us that if the return is less certain or of greater risk, other things being equal, investors will expect a higher return.

The current sums of money for an individual ODI relating to rewards and penalties varies significantly by company. For example we note that for example the impact of failing the MZC ODI results in over a £1 reduction for us at Portsmouth but only half of this for SES Water. This does not feel right.

We believe, as a principle, there should be greater comparability on the rewards and penalties.

## **Better reflecting resilience in outcomes**

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

Reflecting resilience through standard metrics is a sound principle and to be supported and encouraged. The simple methods of measuring as suggested on p16 of Appendix 3 are generally clear and easily understood by our customers.

We believe they are easily transferable to an outcome measurement framework and a good start for discussion and review.

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

A return towards a standardised approach to asset health is sensible and should build on the approach already historically developed in the “Common Framework”.

Asset health should be driven by a clear CBA approach and companies only penalised if asset health is failing and resulting in resilience issues that expose customers to interruptions of supply. A standard approach across the industry is therefore to be encouraged so that customers and stakeholders may easily compare companies’ positions.

A reward for early achievement of a stretched performance commitment is only appropriate if the existing performance is already below a recognised standard, given the CBA described above will have determined the appropriate timing of the expenditure.

We would support standardisation of asset health measures with companies allowed to propose specific measures which will be pertinent to their situation. As with other commitments, we would want to understand the cost of collecting and reporting all of this information to meet regulatory expectations and the need to increase the burden on companies given the objective is still to focus on the outcome.

## **Making performance commitments more transparent**

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

There are four specific proposals raised in the consultation to ensure performance commitments are more transparent to customers.

We comment on each in turn:-

#### **1. Principles to make performance commitments easier to understand**

We challenge the view that our current performance commitments are not easily understood, at least by the CCG. This is because they were significantly involved throughout the process of development.

However, the customer research we have recently undertaken has challenged some of the descriptions of some performance commitments. For example the metric relating to interruptions to supply, where an average time of interruption is reported, is considered misleading as typically a small number of customers experience a significantly greater interruption to that reported which is typically less than 20 minutes. We should consider how this can best be reported.

We propose to undertake an internal exercise to write our current ODIs in “non-technical language” in preparation for PR19. We also note the expectation to submit performance commitment definitions to Ofwat prior to the business plan in September 2018. This is a sensible development.

#### **2. Reporting of sub measures**

There is a risk that sub-measures are both difficult for stakeholders to understand and moves the debate away from the focus on Outcomes to the detail of the cause. We strongly caution this approach.

Their re-introduction would be a step backwards to pre PR14, which focused on inputs and outputs, not outcomes, more for regulatory purposes than those of the customer. Further this will increase the regulatory reporting burden to ensure accurate data is placed in the public domain.

#### **3. Disseminating performance information effectively**

We agree this needs to be considered carefully. It is an important component of ensuring trust in the company remains and explaining to customers what they are paying for.

#### **4. Increasing the focus of performance commitments on outcomes**

We agree that choosing appropriate performance commitments to demonstrate performance on an outcome is an important conversation to have with customers and stakeholders.

We agree that in many cases Outcome Delivery Incentives were developed, in association with Ofwat's challenge, relatively late in the PR14 process and that this issue was not fully thought through.

We welcome therefore the proposals in the consultation on this issue and more generally to improve the overall process to deliver a set of challenging targets which will genuinely improve customer experience.